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Supreme Court of the United States.

OCTOBER TERM, 1915.
No. 140.

FRANK R. BRUSHABER,
Appellant,

against

UNION PACIFIC RAILROAD COMPANY,
Appellee.

BRIEF FOR APPELLANT.

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Supreme Court of the United States.

OCTOBER TERM, 1915.

FRANK R. BRUSHABER, Appellant, AGAINST UNION PACIFIC RAILROAD COMPANY, Appellee.	No. 140.

BRIEF FOR APPELLANT.

In this case the Court is asked to review the record made up by the final judgment of the District Court for the Southern District of New York, dismissing the cause on demurrer.

The case presents the constitutionality of certain provisions of the Income Tax Law of 1913, constituting Section 2 of the Act of October 3, 1913, adopted at the first session of the Sixty-third Congress, and entitled "An Act to Reduce Tariff Duties and Provide Revenue for the Government and for Other Purposes".

The action was brought on the equity side of the Court by the appellant, a stockholder of the defendant, to enjoin the latter from complying with the provisions of said statute, including the making of returns and paying taxes deducted from the income of others.

Statement of Facts.

The bill avers as follows: The defendant is a Utah corporation, with its executive offices in New York City. By its charter and By-Laws the general control of its business and affairs is entrusted to the directors as a board and an executive committee of that board. The plaintiff owns 500 shares of the defendant's stock (Rec., pp. 2–3).

The defendant has charter power to engage in business as a common carrier operating a line of railway for that purpose and also to mortgage its lines, to acquire property including the stocks of other railroad corporations, and to operate, by lease or by contract, lines of railroad belonging to other companies. Its outstanding preferred stock amounts in par value to ninety-nine million five hundred forty-three thousand five hundred dollars ($99,543,500) and its common stock to two hundred sixteen million six hundred thirty-three thousand nine hundred dollars ($216,633,900). Upon both of these classes of stock, dividends have been paid for many years. Pursuant to its charter power, the Company has outstanding bonds as follows:

$100,000,000 par value of fifty-year four per cent. gold bonds due July 1, 1947, with interest payable semi-annually; secured by first mortgage dated July 1, 1897, including certain assets;

$65,085,280 of first lien and refunding mortgage bonds due June 1, 2008, with interest payable semi-annually; secured by mortgage dated June 1, 1908, covering certain lines of railroad.

$37,435,700 twenty-year convertible bonds due July 1, 1927, with interest payable semi-annually; secured by mortgage dated July 1, 1907.

All bonds of each series contain the common "tax free clause" obligating the mortgagor to pay

the principal and interest of the bonds without deduction for any taxes which the Company may be required to pay or retain therefrom under any present or future law of the United States, or of any state or political sub-division thereof (Rec., pp. 3–4).

The bill then recites the adoption of the Tariff Act of October 3, 1913, the second section of which contains the income tax law, and proceeds to give the salient provisions of this statute (Rec., pp. 4–10). Then the bill avers that the defendant comes within the provisions of this law. In order to comply therewith the Company must (*a*) make the returns provided for therein; (*b*) pay a normal tax of one per cent. upon its net income; (*c*) deduct and withhold the normal income tax of one per cent. on all coupons and interest on its outstanding bonds with respect to every individual either a holder or owner of coupons or entitled to interest on bonds, who may not have filed with the defendant notice of claim to the exemption of $3,000 or $4,000, allowed by the statute, and (*d*) pay to the Government the tax of individuals so deducted and withheld (Rec., p. 10).

The bill then avers that the defendant, and its directors controlling its affairs, intend voluntarily in the future from year to year, to comply with the provisions of the Statute in the following respects:

(*a*) It will make returns of net income and pay taxes imposed upon its net income;

(*b*) It will deduct and withhold the normal tax upon coupons and interest paid to individuals who are holders of its coupons or entitled to interest on its bonds;

(*c*) It will make returns to the Government of the taxes so deducted and withheld;

(*d*) It will pay these taxes to the Government;

(*e*) It will return to the Government its net income for the ten months of the year 1913 from March 1, 1913, to January 1, 1914;

(*f*) It will pay such tax upon its net income for said period of ten months as may be imposed thereon by the Commissioner of Internal Revenue (which tax will greatly exceed the sum of $3,000);

(*g*) It will return the amounts of the normal income tax deducted and withheld by it upon coupons and interest heretofore paid by individuals who have not claimed the exemption of $3,000–$4,000.

(*h*) It will pay over the normal income taxes so deducted and withheld to the Collector.

The bill then states that unless restrained by injunction, the defendant will (*a*) on or before June 30, 1914, pay such income tax as may be assessed against it for the ten months of the year 1913; (*b*) on or before June 30, 1914, pay the normal income tax of 1 per cent. deducted and withheld upon coupons and interest paid to individuals who have not claimed the exemption of $3,000–$4,000; (*c*) in ensuing years, make such returns and deduct and withhold and pay such taxes as the provisions of the statute purport to require (Rec., pp. 10–11).

The bill then proceeds to analyze this statute in the light of its validity under the constitutional limitations imposed upon Congress (Rec., pp. 11–24). It then concludes that the provisions of this act constitute one entire independent system of taxation; and that, inasmuch as the provisions which have been referred to are unconstitutional and void, the statute is in all respects unconstitutional and void, and any tax which may be levied thereunder upon the

defendant is and will be unconstitutional in every respect (Rec., p. 24).

The bill alleges that the suit is not collusive. It shows that due demand was made by the plaintiff upon the Company's board of directors that the Company should refuse to comply with the provisions of said act, and should take such action as might be necessary to test its constitutionality and that this demand was wholly refused. The bill further says that it will be impossible to have this action of the board of directors reviewed by the stockholders of the Company, because the next meeting of the stockholders would not take place until late in the year 1914, before which time the threatened action of the Company with respect to taxes imposed for the year 1913 would be consummated; and that a special meeting of the stockholders can only be had by order of the board of directors or the executive committee, or by written application of stockholders owning not less than one-third in amount of the capital stock. In view of the position taken by the defendant's executive committee, it would be useless to apply to it or to the board to call a special meeting; and in view of the large number of stockholders and the necessity of publication of notice of a special meeting for three weeks, it would be impossible to obtain the co-operation of a sufficient number of stockholders and the publication of notice within any reasonable time (Rec., pp. 24–5).

The bill then avers that the making of these returns, and payment of the taxes, will result in a great diversion and misappropriation of the corporate assets, and lessen and diminish the interest of the shareholders in the corporation, that unless injunctive relief is granted, the defendant will pay taxes for 1913 and each year in the future, and will also lose the taxes unnecessarily paid in behalf of its bondholders; or the Company will be put to great expense to ascertain which of its bondholders are

exempt from the statute's operation, and to bring numerous suits against the officers of the Government to recover back the taxes thus paid. It is alleged that in any such suits the issues to be determined would involve the same issues offered by this bill, and that issues can be determined more speedily and conveniently in the present action, and the granting of the relief will prevent a multiplicity of suits (Rec., pp. 25–6).

The amount of taxes upon the defendant's income for 1913 exceeds $300,000. The taxes already deducted by the company on account of its bondholders' income, who have not claimed exemption, and with respect to whom the defendant has covenanted to pay taxes required to be withheld, amount to over $6,000.

The bill then avers that the plaintiff has no adequate remedy at law; states that it is filed in behalf of the plaintiff and all other stockholders who may contribute, and prays for the following relief:

(1) That the provisions of the income tax law relating to making returns of net income and payment of taxes imposed upon the net income of corporations, particularly with respect to the period from March 1, 1913, to October 3d, 1913, be adjudged unconstitutional, so far as any tax is sought to be imposed thereby upon the corporate defendant.

(2) That the defendant be enjoined from making a return of its net income or paying any tax thereon, particularly for the said period from March 1, 1913, to October 3, 1913, or from paying any taxes upon income received as dividends upon the stocks of corporations held by it which are subject to taxation upon their incomes under said Act.

(3) That the provisions relating to deduction at the source of taxes upon the income of the Com-

pany's bondholders and making returns and paying such taxes be declared unconstitutional.

(4) That the defendant be enjoined from making any return of taxes upon its coupons or registered interest relating to its outstanding mortgage bonds, or deducting or withholding any such tax, or from paying the same to any collector.

(5) For a temporary injunction to the same effect.

The defendant demurred to the bill upon the ground that Section 2 of said Act was in all respects constitutional and valid (Rec., p. 30) and the Court sustained the demurrer and dismissed the bill on that ground (Rec., p. 31).

Specification of Errors.

The appellant presents the following assignment of errors upon which he relies upon this appeal (Rec., pp. 32–3).

First: That the Court erred in adjudging that section 2 of the Act of the first session of the Sixty-third Congress, which became a law on October 3rd, 1913, generally known as the Tariff Act, is constitutional and valid and that said section was not violative of the third clause of the second section of Article I and the fourth clause of the ninth section of Article I and the first clause of the eighth section of Article I and the implied limitations and restrictions upon the taxing power of the United States contained in the Constitution of the United States and of Article V of the amendments to the Constitution of the United States.

Second: That the Court erred in adjudging that the provisions of section 2 of the Act hereinabove

referred to relating to making returns of net income and payment of taxes imposed upon the net income of corporations, so far as any tax is sought to be imposed thereby upon the property of the defendant Union Pacific Railway Company by reason of the receipt of income prior to October 3rd, 1913, are constitutional and valid.

Third: That the Court erred in adjudging that the provisions of section 2 of the Act hereinabove referred to purporting to impose upon the Union Pacific Railroad Company the duty of deducting and withholding taxes upon income of individuals arising or accruing from coupons or registered interest and making returns and payments to Collectors of Internal Revenue with respect to such amounts so withheld, are constitutional and valid.

Fourth: That the Court erred in adjudging that the provisions of section 2 of the Act hereinabove referred to relating to making returns of net income and payment of taxes imposed upon the net income of corporations, so far as a tax is sought to be imposed upon the income of the defendant Union Pacific Railway Company received as dividends upon the stocks of corporations held by it which were also subject to taxation upon their net income under said Act, are constitutional and valid.

Fifth: That the Court erred in not decreeing that the complainant was entitled to the relief prayed for, or some part thereof.

Sixth: That the Court erred in dismissing the bill of complaint, with costs.

POINT FIRST.

The effect of the Sixteenth Amendment was merely to waive the requirement of apportionment among the States, in its application to a general and uniform tax upon incomes from whatever source derived. The Income Tax Law of 1913, except in so far as the tax thereby imposed is in reality such a general and uniform tax on incomes, derives no support from the Sixteenth Amendment.

Not only the language of the Sixteenth Amendment, but judicial history leading up to its passage, clearly shows its purpose and the construction which should be placed upon it.

Article 1, Section 2, Subdivision 3 of the Constitution provides:

> "Representatives and direct taxes shall be apportioned among the several states which may be included within this Union, according to their respective numbers, which shall be determined by adding to the whole number of free persons, including those bound to service for a term of years, and excluding Indians not taxed, three-fifths of all other persons."

Article 1, section 9, subdivision 4 provides:

> "No capitation or other direct tax shall be laid, unless in proportion to the census or enumeration hereinbefore directed to be taken."

A census was provided for within three years from the first meeting of Congress, and thereafter every ten years.

It is part of the history of the Constitution, generally known and recognized, that the purpose of

the provision just quoted was to prevent Congress from imposing a direct tax which would constitute a disproportionate burden on any part of the Union.

Scholey vs. *Rew*, 23 Wall. 331.
Ward vs. *Maryland*, 12 Wall. 418.

Congress, in 1894, adopted an Act entitled "An Act to reduce taxation, to provide revenue for the government and for other purposes," by which a general and uniform tax was imposed upon all incomes from whatever source derived, accrued or received after January 1, 1895, and exceeding four thousand dollars in any year, for each taxpayer or group of taxpayers constituting one family.

In *Pollock* v. *Farmers Loan & Trust Co.*, 158 U. S. 601, this Court, in declaring the Act of 1894 to be unconstitutional, construed the above-quoted clauses of the Constitution as ordaining that no direct taxes could be levied unless in proportion to the enumeration; and held that a tax on income, whether from real or personal property, is a direct tax upon the property from which the income is derived.

It was these constitutional provisions which, prior to 1913, stood in the way of *any* income tax imposed without apportionment.

The Sixteenth Amendment, ratified March 1, 1913, provided:

> "The Congress shall have power to lay and collect taxes on incomes from whatever source derived without apportionment among the several States and without regard to any census or enumeration."

The evident purpose of this amendment was not to abandon the former policy of safeguarding the several sections of the Union against disproportionate taxation, but merely to substitute an apportionment according to "incomes from whatever

source derived," in lieu of a *per capita* apportionment.

The utmost care was used and the clearest intention displayed to remove the necessity for a *per capita* apportionment; but there is no evidence of an intention to change the spirit or effect of the Constitution in any other respect. The expression of the purpose to abrogate merely the one limitation excludes the implication of a purpose to affect any others. The income tax contemplated by the amendment is, accordingly, an income tax preserving in all respects rights secured by the Constitution, but freed from the necessity of *per capita* apportionment. Congress, when it came to legislate on the subject, found its powers in no wise broadened by this amendment save in the one respect mentioned.

Construction of the Amendment.

Obviously, it was not in favor of any and every piece of legislation which Congress might choose to call an income tax, that the Amendment was intended to operate, but only in favor of a "tax on incomes from whatever source derived," according to the fair and natural import of those words and the sense in which they would ordinarily be understood by the people who through their lawful representatives adopted the Amendment. From this it follows, as we contend, that the Sixteenth Amendment has no application, for example, to

(*a*) A tax upon incomes artificially created by statutory definition, but only to a tax on true net incomes coming fairly within the meaning of the word as commonly used and understood at the time when the Amendment was adopted and ratified.

(*b*) A tax upon a specific kind of property, measured by income; as, for example, a tax of ten per cent. on the income of all gold mines in the United States.

(*c*) A tax on a particular form or mode of ownership of property, measured by income, as, for example, a tax on rents or on the profits of leasehold estates.

(*d*) A tax upon a specific class of persons, measured by income; as, for example, a tax of ten per cent. on the income of all unmarried men.

(*e*) A tax upon money or property which is not income at the time when it is taxed although it may have been received as income at some prior period.

(*f*) A tax in the form of forced labor in making deductions and payments out of the income of others, not resting upon any principle of classification or other method of distributing the burden, except the convenience of the government.

As bearing upon the construction of the Sixteenth Amendment in the application to such problems, the fundamental thought which we desire to present is that it was not the intention of those who adopted and ratified that Amendment, nor is it fairly within the language of the Amendment, to invest Congress with a power of regulation and control, by means of discriminating taxes, over all the activities of life which involve the production of income, or over all the details of existence on the part of those who receive income; but only to strengthen the powers of Congress in respect to the production of revenue, by substituting one safeguard in lieu of another, as a protection against oppressive treatment of any section or part of the Union.

The requirement of generality and uniformity is inherent in the language of the Amendment. The law to which the Amendment is by its terms appli-

cable is one taxing *incomes only.* A law which places the burden of taxation partly on incomes because they are incomes and partly upon specific kinds of property or forms or modes of ownership of property or other sources of income is not a tax on incomes pure and simple such as the Sixteenth Amendment contemplates; and, therefore, to the extent to which it involves direct taxation, it can be justified, if at all, only upon some ground other than that afforded by the Sixteenth Amendment. In determining on what the tax rests, it is the incident or quality which draws down the burden of taxation which must be considered. If upon a general income tax law there has been engrafted a provision that the income from sugar plantations shall be taxed at the rate equal to four times the normal tax, the provision for the additional rate, according to the ordinary use of language and the ordinary current of thought, does not constitute a tax upon income, but a tax upon sugar plantations. It is the character of the source of income and not the mere fact of the receipt of income that draws down that part of the burden. Likewise, if there were engrafted upon a general income tax law a provision that the income from real property not occupied by the owner should be taxed at four times the normal rate, such additional provision would not be in substance and truth a tax upon income, but, to the extent of the additional burden of three per cent., it would be a tax upon the relation of landlord and tenant—that is to say, upon a form or mode of holding and using property, deriving its authority wholly from State laws and exempt from the control of the National Government under the general system or the distribution of governmental powers embodied in the Constitution. Discriminations, inequalities, exemptions and artificial rules of computation are excluded from any income tax law which purports to derive its authority from the Sixteenth Amendment, because

they necessarily involve the taxing of something other than income, whereas the evident purpose of the Amendment is to relax the constitutional requirements designed to protect the various sections of the community against oppressive and disproportionate taxation only in favor of a general and uniform tax on net incomes for the purpose of revenue only, which, by its inherent nature, would necessarily serve substantially the same purpose as the constitutional provisions which were relaxed in its favor.

Manner and order of presenting specific questions.

In the subsequent points of this brief and the briefs filed in the two cases which are to be argued simultaneously herewith, it is argued that the Income Tax Law of 1913, in many respects, goes beyond the constitutional limits of the taxing power of Congress and particularly that it imposes direct taxes without apportionment in cases not coming fairly within the spirit and letter of the Sixteenth Amendment. The specific objections to the act are discussed at length only in the particular cases where they have a direct and material bearing upon the rights and interests of the several appellants before the Court. No objection is urged unless it is applicable to a concrete case presented by the pleadings. The grounds of objection discussed in these three cases by no means exhaust the list of those to which the Act is fairly subject. In the bill in the *Brushaber* case (Rec., pp. 13–23) many others are suggested, but it is considered that the fundamental principles involved in the discussion will be adequately presented for decision, by keeping these briefs within the limitations above stated.

Comparison of Present Income Tax Law with prior Laws.

In respect to discriminations, inequalities, artificial definitions and indirect penalties having no relation to the production of revenue, the present Income Tax law not only goes far beyond any of the former laws passed by Congress but beyond any precedent to be found in the whole history of financial legislation. Even the laws passed during the period of the Civil War, when the constitutional limits upon the powers of Congress were poorly defined and patriotic reasons led to general acquiescence in any measures deemed necessary to sustain the public credit, contained fewer objectionable features than are found in this law of 1913. The Act of 5 August, 1861, placed a tax of 3 per cent. on incomes generally with an exemption of $800, but it was in no respect retroactive, contained no provision in regard to collection at the source, and provided for no surtax. The Act of 1 July, 1862, contained no retroactive feature, but provided for a surtax, and in placing a tax upon certain corporations authorized them to deduct the tax from payments made on account of dividends to other parties, and also provided that there should be deducted by the paymasters and all disbursing officers of the United States Government a tax levied upon all salaries of officers or payments to persons in the civil, military, naval or other employment or service of the United States, including senators and representatives and delegates in Congress. The Act of 30 June, 1864, placed a tax on incomes for the year ending the 31st of December following, provided for partial collection at the source, dividends being taxed in the hands of certain corporations and the stockholders permitted to deduct the amount from their estimates. The tax was 5 per cent. on incomes in excess of $600 and not exceeding $5,000, 7-1/2 per cent. on incomes in excess

of $5,000 and not exceeding $10,000, and 10 per cent. on incomes in excess of $10,000.

The Joint Resolution of 4 July, 1864, levied a special income tax "for the year ending the 31st day of December next preceding the time herein named." The Act of 14 July, 1870, contained a provision in regard to deduction at source by banks and trust companies. It was to be collected only for the years 1870 and 1871.

All of these taxes were direct taxes. No provision was made for apportionment. The entire legislation was unconstitutional.

As Mr. Justice FULLER says in the Pollock case, 157 U. S., at page 573,

> "These acts grew out of the war of the rebellion, and were, to use the language of Mr. Justice Miller, 'part of the system of taxing incomes, earnings and profits adopted during the late war and abandoned as soon after that war was ended as it could be done safely' (Railroad Company *vs.* Collector, 100 U. S. 595, 598)."

The provisions in regard to deduction at the source caused inconvenience and confusion, which only the necessity of raising large amounts of money in a short time seemed to justify. In *Barnes* v. *The Railroads*, 17 Wall. 294, the Court, at page 304, said:

> "Different regulations for the assessment and collection of the income taxes of every kind were prescribed in the prior laws imposing internal revenue duties, but they were not in all respects satisfactory, and many controversies have arisen calling in question the action of the revenue officers in their efforts to enforce the collection of that branch of the public revenue. Contrariety of decision has resulted in some instances, and the Circuit Court has decided in one case that a railroad company could not deduct and withhold the amount of such a tax from a dividend due and payable to a non-resi-

dent alien, the presiding Justice being of the opinion that the language of the prior act did not warrant the conclusion that Congress intended to include such holders of bonds or securities in the category of the persons liable to such an assessment."

The provision in regard to the deduction by federal disbursing officers of the tax from the salaries of all persons in the civil, military, naval or other employment or service of the United States was applied to the salaries of federal judges and was the subject of a letter of protest by Chief Justice TANEY, which letter by order of the Court was entered upon the records of the court on the 10th of March, 1863. It was, however, deemed unpatriotic by the federal judges during the war to resist the collection of the tax (Foster Income Tax, 2d Ed. 1915, pp. 96, 98).

The entire series of income taxes of the period being unconstitutional because not apportioned, the various provisions found in this system of taxation furnish no warrant for the constitutional propriety of similar provisions in the present Act. The present Act is not temporary in character, and no stress of circumstances silences the contention that it should strictly conform to all the constitutional guaranties.

Conclusion.

The conclusion is evident that the income tax now authorized by constitutional amendment to be laid without apportionment must be a true and genuine income tax conforming in extent, method of collection, and classification to the supreme law of the land in every respect except dependence upon enumeration, and that the objections herein urged, had they been valid before the Sixteenth Amendment, have equal virtue now.

In thus insisting that the Sixteenth Amendment be confined in its operation to the real purpose which called it into being we believe that we are seeking to strengthen and not to limit the fiscal powers of Congress. If Congress has the power to engraft upon an income tax law exemptions, discriminations and inequalities or to favor particular sections and interests, the passage of such a law even in times of great national emergency, will be delayed by the struggle for personal and political advantage, and in proportion as such struggles are successful the substance of the law will be weakened, its administration be made more difficult and its revenue-producing power diminished.

If, on the other hand, it is now declared and known that under the operation of the Sixteenth Amendment the only income tax law that can be adopted without apportionment is one which is simple and direct in its methods and general and uniform in its operation, not only will the financial position of the government be strengthened in times of emergency, but the original purpose of the provision requiring apportionment will be preserved and made effective through the automatic operation of the requirement that the tax to be imposed must be a general tax upon "incomes from whatever source derived", merely because they are incomes, and not because of their size or their source or any other quality or incident whatsoever.

POINT SECOND.

So much of the Act of October 3d, 1913, as subjects certain corporate earnings to the normal tax of one per cent. as income of the operating corporation, and again subjects the same earnings to a like tax while in process of distribution to the beneficial owners through the instrumentality of an intermediate corporation, operates as a discrimination in the nature of a penalty on corporations holding stock in other corporations and necessarily conflicts with the right of the several States to determine for themselves the permissible forms and modes of ownership of property.

The general plan of the Income Tax Law is to tax income but once, no matter through what number of hands it may be transmitted for distribution to the beneficial owner. Only in so far as it conforms to this plan can the Act be deemed to constitute a general income tax law such as is contemplated by the Sixteenth Amendment. There have been engrafted upon the Act, however, certain provisions, manifestly having no relation to the production of revenue, which place a special burden upon particular forms or modes of owning property or distributing income. An instance of such a foreign element, separable no doubt from the main body of the Act, is the clause designed to discourage corporations from holding stock in other corporations.

The Act, by Paragraph B, subdivision 1 of Section 2, allows the individual taxpayer a deduction of "the amount received as dividends upon the stock or from the net earnings of any corporation, joint stock company, association or insurance company which is taxable upon its net income as hereinafter provided." There are no similar provisions in regard to the corporate taxpayer, and no similar deduction is allowed to it. The result is that the corporate taxpayer which owns stock in other corporations is subject to a disproportionate burden of taxation in the nature of a penalty based upon a classification which must be regarded as arbitrary because having no relation to any power conferred upon Congress by the Constitution.

The situation cannot be considered to be the result of oversight, for the deduction here denied was expressly allowed to corporations under Section 38 of the "Corporate Tax Law" of August 5th, 1909, and also under Section 28 of the Income Tax Law of 1894.

Concrete operation upon the parties to this cause.

The burden thus imposed bears heavily upon the Union Pacific Railroad Company and upon the rights of the plaintiff. The bill shows that the defendant Railroad Company owns stock of other corporations to the amount of several millions of dollars in value and during the year 1913 received large sums of money as dividends on said stock (Rec., p. 17, fol. 28). As is well known from other records in this Court the Railroad Company is the owner of the entire capital stock amounting to $100,000,000 of the Oregon Short Line Railroad Company which in its turn is the owner (except of 15 shares) of the entire capital stock amounting to $50,000,000 of the Oregon-Washington Railroad and Navigation Company. Both the last-named corporation and the

Oregon Short Line are consolidations of the original corporations by which branches and extensions of the Union Pacific system were constructed, the use of separate subsidiary corporations for that purpose being compelled by financial reasons. The growth of every great railroad system in the country shows the same history. Without the gradual amalgamating instrumentalities of leases, stock-ownership, divisional mortgages and mergers, those systems would not have been formed so rapidly or along such natural lines.

The Union Pacific Railroad Company is also, as the records show, the owner of stock in a fruit express company, an equipment association and various other corporations engaged in business other than railroad business, but incidental thereto. The effect of the discrimination against corporations holding stock in other corporations contained in the Act of 1913, is in substance to compel the Union Pacific Railroad Company to pay the tax three times upon income derived through the instrumentality of the Oregon-Washington Railroad and Navigation Company, and twice in the case of income derived through the other controlled corporations.

It will scarcely be contended that Congress has general power to regulate the form or mode of ownership of property within the several states. Still less has Congress the power to impose a direct tax upon property, without apportionment, because of the form or mode of ownership. The public policy of the several states upon the subject in question is not uniform. In all the States the ownership by railroad companies of the stock of other railroad companies, not having parallel or competing lines, is permitted or encouraged. In some states railroad companies, while permitted to own stock in manufacturing and mining corporations producing materials suitable for use in the railroad business, are

not themselves permitted to engage in any business other than that of transportation. In other states a different policy prevails. Except as interstate commerce may be directly affected, the general theory of the distribution of governmental powers embodied in the constitution requires that the several States should have full power to give effect to their own views of public policy in such matters within their own borders. One of the most important questions presented by this case is whether Congress can substitute its own judgment upon such questions for that of the states responsible for the creation and regulation of the corporations affected, under the guise of a classification of corporations, based upon differences entirely unrelated to any power or function given to the Federal Government by the Constitution.

The Union Pacific Railroad Company, like most other railroad companies, is invested by the State of its creation with the franchise to own and manage its property and to develop its system and enlarge its facilities according to the methods which experience has shown to be best adapted to that end, including the construction of branches and extensions and the provision of new facilities and equipment by means of separate subsidiary corporations, for the purpose among other things of convenient financing. Congress assumes by the Act of 1913 to divide such corporations into two classes, those which do and those which do not exercise, in the particular mode here under discussion, the franchises given them by the State of their creation for the more effective accomplishment of their corporate purposes. A special and additional tax in the nature of an excrescence upon the general system for the taxation of incomes is imposed upon those who exercise fully the franchises given to them, as it must be assumed, in furtherance of the public policy of the State. This, we submit, is not reasonable classification.

Limitations upon the power of classification possessed by Congress.

The power to make laws and impose taxes is a sovereign power and must be exercised with due regard to the nature and limitations of the sovereignty. Where sovereignty is divided, as it is under our form of government, the reasonableness or unreasonableness of classification depends somewhat on the scope and character of the general legislative power which is being exercised. A State having plenary authority over the details of domestic life may make classifications which would be out of place in an act of Congress. Classification which would be approved in a tax law might be thought arbitrary in a statute passed in the exercise of the police power. A State which should classify merchants for the purpose of taxation, according as they did or did not exercise the privilege given by Congress of distributing their merchandise through the mails, or the privilege of engaging in interstate commerce, would clearly be making a classification based upon matters outside the scope of its sovereignty (*Guy* vs. *Baltimore*, 100 U. S. 434). The same classification made by Congress might perhaps be held to be within its power.

So we contend here that Congress in classifying corporations for the purpose of taxation, according to their plan or mode of owning property within State boundaries and under State-given franchises, is attempting a classification based upon a matter outside the scope of its sovereignty, and is, moreover, going far outside the scope of a general and uniform income tax law such as was contemplated by the Sixteenth Amendment.

In this connection a distinction should be observed between the primary powers of Congress over matters in respect to which plenary jurisdiction is given by the Constitution and the secondary or ancillary

powers, not exclusive in their nature, which can be exercised only to the extent that they are necessary or appropriate in aid of the primary powers.

The power of Congress over foreign commerce is a primary power. It may prohibit such commerce altogether or may regulate it or convert it into a source of revenue according to any method or principle of classification, not purely arbitrary, which it sees fit to adopt. The same may be said of the power over the postal service or over interstate commerce or over the public lands. For this reason tariff laws must be looked upon with caution when they are referred to as precedents in other fields of tax legislation.

Congress also has power to provide for the administration of oaths and the examination of witnesses, but this is not a primary power. It can be exercised only as an incident to some exercise of jurisdiction flowing from the existence of one or more of the primary powers (*Kilbourn* vs. *Thompson*, 103 U. S. 168; *In re Chapman*, 166 U. S. 661). Likewise Congress has power to define crimes and provide for their punishment, but this also is an ancillary, not a primary power (*U. S.* vs. *Fox*, 95 U. S. 670; *U. S.* vs. *Harris*, 106 U. S. 629). In *U. S.* vs. *Fox* (*supra*) Mr. Justice FIELD delivering the unanimous opinion of the Court said (p. 672):

> "Any act committed with a view of evading the legislation of Congress passed in the execution of any of its powers, or of fraudulently securing the benefit of such legislation may properly be made an offense against the United States. But an act committed within a State, whether for a good or a bad purpose, or whether with an honest or a criminal intent, cannot be made an offense against the United States, unless it have some relation to the execution of a power of Congress, or to some matter within the jurisdiction of the United States. An act not having any such relation is one in respect to which the State can alone legislate."

Congress has the power to tax and it is a very important power, but it is not a primary power. It is not plenary and exclusive like the power over foreign commerce. The production of revenue is a purpose of such urgent necessity that any feature of a tax law that is adapted to that end, and is not at variance with any express constitutional limitation, must be deemed valid. Discriminations, exemptions and inequalities, however, have no presumptive relation to the production of revenue; they diminish rather than increase the effectiveness of the law as a fiscal measure and, if justified at all, must be justified because of their relation to some other matter within the jurisdiction of the sovereignty which makes the law, to which the taxing power may properly be adapted and made subservient.

All these considerations lead to two conclusions:

(1) The classification of the subjects of taxation contained in any tax law, in order to be valid, must be based on differences having a reasonable relation to some field of jurisdiction of the authority which imposes the tax.

(2) The classification of the subjects of taxation in an income tax law, in order that such law may be entitled to the benefit of the Sixteenth Amendment, must have a reasonable relation to the production of revenue from incomes without regard to source.

Holding stock in other corporations is not a legitimate basis of classification in a federal tax law.

That the provisions of the Act of 1913, here under discussion, will meet neither of these tests is immediately apparent. There is no basis whatever for the classification found in the Act other than a certain prejudice which is in the air against holding companies. By a holding company we

understand a corporation which has as its main excuse for existence the holding of stock in other corporations. Because some corporations which hold stock in other corporations are holding companies, therefore this Act imposes a disproportionate tax on all corporations so situated, although the general question whether a corporation chartered by a State shall or shall not be permitted to hold the stock of another corporation is admittedly beyond the jurisdiction of Congress.

This legislative disapproval of holding companies is shown in other parts of the Act. Subdivision 2 of Section 11 provides for two cases of presumed fraudulent purpose to escape the tax: where gains and profits are permitted to accumulate beyond the reasonable needs of the business, such accumulation being certified as unreasonable by the Secretary of the Treasury, and where the corporation, joint stock company or association *is a mere holding company*. In other words, a mere holding company is for the reason alone that it is such, presumed to be fraudulent in purpose.

A more flagrant instance of arbitrariness in the exercise of the taxing power could hardly be imagined. Dividends upon stock owned by an individual are taxed once when the earnings of the corporation are taxed and they are not taxed again. The same dividends, when the stock is held by a corporation, are taxed twice; once when the earnings of the corporation issuing the stock are taxed, and a second time when the earnings of the corporation owning the stock are taxed. A certain class of owners is singled out for special burden for no other reason than the disapproval of Congress in respect to the method used in holding title to their property.

It is obvious that this process of taxing the same amount of money over and over again would be repeated as often as the original dividend of the first

corporation issuing stock passed along through different holding companies and was represented in the earnings of those companies. The same amount of money would be taxed as many times as it passed from one holding company to another, and the process of taxing it would not cease until the amount of the first dividend finally reached the hands of individual owners of the capital stock of the last holding company. In the case of the Union Pacific Railroad Company this process results in taxing *three times* the earnings of a corporation having a capital stock of $50,000,000. There is no reasonable ground of classification for the purpose of taxation between an individual as owner of stock of a corporation and a corporation as owner of the stock of another corporation. To uphold such a discrimination would be to construe the Sixteenth Amendment as giving Congress the power to tax incomes at different rates according to the sources that produced the income. This is precisely the power that Congress has sought to exercise in creating this discrimination between individuals and corporations as the owners of corporate stock. The income of an individual when composed of dividends of corporations is not subject to the normal tax. The earnings of corporations when composed of dividends of corporations are subject to the normal tax. This discrimination cannot be upheld on the ground that it is an excise tax upon corporations for or by reason of doing business in a corporate capacity, for the burden does not fall upon all corporations or upon those doing certain kinds of business. Nor is it confined to corporations which do business at all. It is a burden placed directly upon a feature of corporate existence which is *distinct from the doing of business* (*McCoach* vs. *Minehill Railway Co.*, 228 U. S. 295).

Authorities condemning arbitrary selection under the guise of classification.

In *County of Santa Clara* v. *Southern Pacific R. Co.*, 18 Fed. 385 (affirmed 118 U. S. 394), Justice FIELD held that a tax law which discriminates between the assessment for taxation of the property of a corporation and of the property of individuals, giving individuals an exemption not granted to the corporation, was unconstitutional. The Act therein concerned declared that a mortgage, deed of trust, contract or other obligation should for the purposes of assessment and taxation be deemed an interest in the property affected thereby, and provided:

> "*Except as to railroad and other quasi public corporations* in case of debts so secured, the value of the property affected by such mortgage, deed of trust, contract or obligation, less the value of such security, shall be assessed and taxed to the owner of the property and the value of such security shall be assessed and taxed to the owner thereof."

Justice FIELD at page 394 said:

> "Instances of every day occurrence will show the effect of this discrimination in a clear light. A natural person and a railroad company own together a parcel of property in equal proportions subject to a mortgage. In estimating the value of the undivided half belonging to the natural person, half of the amount of the mortgage is deducted. In estimating the value of the undivided half belonging to the railroad company, no part of the mortgage is deducted. The discrimination is made against the company for no other reason than its ownership. * * * Everyone sees that the valuation has not in fact changed with the ownership and therefore that the discrimination is made solely because a rule is adopted in the assessment of the property of one party different from that applied in the assessment of the property of the other, purely on

account of its ownership. A corresponding difference in the tax which the different owners must pay follows the assessment. Thus, if two adjoining tracts are subject to a mortgage, each for half its value, the natural person owning one of them pays a tax on the other half, while the corporation must pay a tax on the whole of its tract; that is, double the tax of the individual. * * *

"The principle which sanctions the elimination of one element in assessing the value of property held by one party, and takes it into consideration in assessing the value of property held by another party, would sanction the assessment of the property of one at less than its value,—at a half or a quarter of it,—and the property of another at more than its value,—at double or treble of it,—according to the will or caprice of the state. To-day railroad companies are under its ban, and the discrimination is against their property. To-morrow it may be that other institutions will incur its displeasure. If the property of railroad companies may be thus sought out and subjected to discriminating taxation, so, at the will of the state, by a change of its constitution, may the property of churches, of universities, of asylums, of savings banks, of insurance companies, of rolling and flouring mill companies, of mining companies, indeed, of any corporate companies existing in the state. The principle which justifies such a discrimination in assessment and taxation, where one of the owners is a railroad corporation and the other a natural person, would also sustain it where both owners are natural persons. A mere change in the state constitution would effect this if the federal constitution does not forbid it. Any difference between the owners, whether of age, color, race, or sex, which the state might designate, would be a sufficient reason for the discrimination. It would be a singular comment upon the weakness and character of our republican institutions if the valuation and consequent taxation of property could vary according as the owner is white, or

> black, or yellow, or old, or young, or male, or female. A classification of values for taxation upon any such ground would be abhorrent to all notions of equality of right among men. Strangely, indeed, would the law sound in case it read that in the assessment and taxation of property a deduction should be made for the mortgages thereon if the property be owned by white men or by old men, and not deducted if owned by black men or by young men; deducted if owned by landsmen, not deducted if owned by sailors; deducted if owned by married men, not deducted if owned by bachelors; deducted if owned by men doing business alone, not deducted if owned by men doing business in partnerships or other associations; deducted if owned by trading corporations, not deducted if owned by churches or universities; and so on, making a discrimination whenever there was any difference in the character or pursuit or condition of the owner. To levy taxes upon a valuation of property thus made is of the very essence of tyranny, and has never been done except by bad governments in evil times, exercising arbitrary and despotic power."

When the case came before this Court (118 U. S. 394) the Court at page 410 stated that the importance of the constitutional questions could not well be overestimated but that they belonged to a class which the Court should not decide unless essential to the disposition of the case. This Court thereupon affirmed on the ground that the entire assessment was a nullity.

The same question was before this Court in *San Bernardino Co.* v. *Southern Pacific R. R. Co.*, 118 U. S. 417. Justice FIELD concurring stated that he regretted that it had not been deemed consistent with the duty of the Court to decide the important constitutional questions involved, and at page 422 stated:

> "At the present day nearly all great enterprises are conducted by corporations. Hardly

an industry can be named that is not in some way promoted by them and a vast portion of the wealth of the country is in their hands. It is therefore of the greatest interest to them whether their property is subject to the same rules of assessment and taxation as like property of natural persons, or whether elements which affect the valuation of property are to be omitted from consideration when it is owned by them and considered when it is owned by natural persons; and thus the valuation of property be made to vary not according to its condition or use but according to its ownership. The question is not whether the state may not claim for grants of privileges and franchises a fixed sum per year or a percentage of earnings of a corporation—that is not controverted—but whether it may prescribe rules for the valuation of property for taxation which will vary according as it is held by individuals or by corporations. The question is of transcendent importance and it will come here and continue to come until it is authoritatively decided in harmony with the great constitutional amendment which insures to every person whatever his position or association, the equal protection of the laws; and that necessarily implies freedom from the imposition of unequal burdens under the same conditions."

In *County of San Mateo* v. *Southern Pacific R. Co.*, 13 Fed. 145, the case had been removed to the Federal Court, and the opinion was written on a motion to remand. Justice FIELD stated that the rule of equality necessitated by the Fourteenth Amendment had been recognized by Congress as applicable to federal taxation, at page 150 saying:

"Equality of protection is thus made the constitutional right of every person; and this equality of protection implies not only that the same legal remedies shall be afforded to him for the prevention or redress of wrongs and the enforcement of rights, but also that he shall be subjected to no greater burdens or charges than

such as are equally imposed upon all others under like circumstances. No one can, therefore, be arbitrarily taxed upon his property at a different rate from that imposed upon similar property of others, similarly situated, and thus made to bear an unequal share of the public burdens. Property may indeed be classified, and different kinds be subjected to different rates. Real property may be taxed at one rate and personal property at another. Property in particular places may be taxed for local purposes, while property situated elsewhere is exempt. License taxes may also vary in amount, according to the calling or business for which they are exacted. But arbitrary distinctions not arising from real differences in the character or situation of the property, or which do not operate alike upon all property of the same kind similarly situated, are forbidden by the amendment Equality in the imposition of burdens is the constitutional rule as applied to the property of individuals, where it is subject to taxation at all; and this imports that an uniform mode shall be followed in the estimate of its value, and that the contribution exacted shall be in some uniform proportion to such value prescribed, according to the nature or position of the property. All state action, constitutional or legislative, impinging upon the enforcement of this rule, must give way before it. Congress, in its legislation since the adoption of the amendment, has recognized this to be the rule. The amendment was adopted in 1868, and in 1870 Congress re enacted the civil rights act; and to the clause that all persons within the jurisdiction of the United States should enjoy the same rights as white citizens, and be subject only to like punishment, pains, and penalties, it added; and be subject only to like '*taxes, licenses, and exactions of every kind, and to no other.*' Rev. St. Sec. 1977."

The idea of uniformity enters into the very definition of a tax. Cooley on Taxation, 3rd Edition, Volume 1, page 1, says:

"Taxes are the enforced *proportional* contributions from persons and property levied by

the State by virtue of its sovereignty for the support of government and for all public needs."

And at page 4:

"They differ from the enforced contributions, loans and benevolencies of arbitrary and tyrannical periods in that they are levied by authority of law and *by some rule of proportion which is intended to insure uniformity of contribution and a just apportionment of the burdens of government.*"

Under our form of government this is an essential feature of taxation and constitutes a limitation upon the power of Congress.

Gray, Limitations on Taxing Power, page 353:

"The view established by authority is that the words as used in the Constitution refer to *geographical uniformity.* It is not intended by this to say that Congress can lay indirect taxes violative of all the principles of equality and uniformity as between persons. Congress *is* limited in this regard; but its limitations are derived not from the words 'uniform throughout the United States,' but from the general nature of all legislative power to tax from the inherent elements of uniformity and equality which partly make up the concepts of taxation and taxes. The restrictions upon Congress in this regard arise from the very nature of legislative power as a power held in trust for the whole people."

Cooley, Constitutional Limitations, pp. 607, 615:

"In the second place it is of the very essence of taxation that it be levied with equality and uniformity and to this end that there should be some system of apportionment. Where the burden is common, there should be a common contribution to discharge it. Taxation is the equivalent for the protection which the government affords to the persons and property of its citizens; and as all are alike protected, so all

> alike should bear the burden. * * * Whatever may be the basis of taxation, the requirement that it shall be uniform is universal."

This principle has been many times recognized in this Court.

In *Loan Assn.* v. *Topeka*, 20 Wall. 655, Mr. Justice MILLER at page 663 said:

> "The theory of our governments, state and national, is opposed to the deposit of unlimited power anywhere. The executive, the legislative and the judicial branches of these governments are all of limited and defined powers.
>
> "There are limitations on such power which grow out of the essential nature of all free governments,—implied reservations of individual rights without which the social compact *could not exist* and which are respected by all governments entitled to the name."

In *United States* v. *Singer*, 15 Wall. 111, the Court at page 121 said:

> "The tax imposed upon the distiller is in the nature of an excise and the only limitation upon the power of Congress in the imposition of taxes of this character is that they shall be 'uniform throughout the United States.'".

In *M'Culloch* v. *Maryland*, 4 Wheat. 316, Mr. Chief Justice MARSHALL at page 435 said:

> "The people of all the states, and the states themselves, are represented in Congress, and, by their representatives, exercise this power. When they tax the chartered institutions of the states, they tax their constituents, *and these taxes must be uniform.*"

In *Ward* v. *Maryland*, 12 Wall. 418, Mr. Justice CLIFFORD at page 431 said:

> "Inequality of burden as well as the want of uniformity in commercial regulations was

> one of the grievances of the citizens under the Confederation; and the new Constitution was adopted among other things to remedy those defects in the prior system."

In *Pollock* v. *Farmers Loan & Trust Co.*, 157 U. S. 429, it was contended that the statute was void for lack of uniformity. The Court summarizing the contention at page 555 said:

> "Under the second head it is contended that the rule of uniformity is violated in that the law taxes the income of certain corporations, companies and associations, no matter how created or organized at a higher rate than the incomes of individuals or partnerships derived from precisely similar property or business. * * * These and other exemptions being alleged to be purely arbitrary and capricious, justified by no public purpose and of such magnitude as to invalidate the entire enactment."

Counsel for all parties including the Attorney General agreed that Congress was limited in its power of taxation to a certain degree of equality and uniformity, that prevented oppressive discrimination against members of the same class with those more favored.

The Court at page 586 stated that inasmuch as the Justices who heard the argument were equally divided upon the question whether the tax was invalid for want of uniformity, no opinion was expressed on that subject. Mr. Justice FIELD, however, in his concurring opinion at page 591 said:

> "The object of this provision (of uniformity) was to prevent unjust discriminations. It prevents property from being classified and taxed as classed, by different rules. All kinds of property must be taxed uniformly or be entirely exempt. The uniformity must be co-extensive with the territory to which the tax applies. Mr. Justice MILLER in his lectures on the Constitution (N. Y. 1891), pages 240,

241, said of taxes levied by Congress: 'The tax must be uniform on the *particular article;* and it is uniform within the meaning of the Constitutional requirement if it is made to bear the *same percentage* over all the United States. That is manifestly the meaning of this word as used in this clause. The framers of the Constitution could not have meant to say that the 'government in raising its revenues should not be allowed to discriminate between the articles which it should tax.' In discussing generally the requirement of uniformity found in state constitutions, he said: 'The difficulties in the way of this construction have, however, been very largely obviated by the meaning of the word "Uniform" which has been adopted holding that uniformity must refer to articles of the same class. *That is, different articles may be taxed at different amounts provided the rate is uniform on the same class everywhere with all people and at all times.*'"

And Mr. Justice FIELD at page 599 further said:

"But there are other considerations against the law which are equally decisive. They relate to the uniformity and equality required in all taxation, national and state; to the invalidity of taxation by the United States of the income of the bonds and securities of the States and of their municipal bodies; and the invalidity of the taxation of the salaries of the Judges of the United States Courts.

"As stated by counsel: 'There is no such thing in the theory of our national government as unlimited power of taxation in Congress. There are limitations as he justly observes of the powers arising out of the essential nature of all free governments; there are reservations of individual rights without which society could not exist and which are respected by every government. The right of taxation is subject to these limitations.'"

The dissenting opinion of Mr. Justice BREWER in *Magoun* v. *Illinois Trust & Savings Bank*, 170 U. S.

283, at 301, is particularly applicable to the case at bar. He says:

> "I am unable to concur in the foregoing opinion so far as it sustains the constitutionality of that part of the law which grades the rate of the tax upon legacies to strangers by the amount of such legacies. If this were a question in political economy I should not dissent but it is one of constitutional limitations. Equality in right, in protection and in burden is the thought which runs through the life of this nation and its constitutional enactments from the Declaration of Independence to the present hour. Of course absolute equality is not attainable and the fact that a law, whether tax law or other works inequality in its actual operation does not prove its unconstitutionality (*Merchants Bank* v. *Pennsylvania*, 167 U. S. 461). But when a tax law directly, necessarily and intentionally creates an inequality of burden, it then becomes imperative to inquire whether this inequality thus intentionally created can find any constitutional justification."

In *Southern Railway Company* v. *Greene*, 216 U. S. 400, it was held that a statute which classified separately domestic and foreign corporations for the purpose of taxation and imposed a greater franchise tax upon foreign corporations than that imposed upon domestic corporations was an arbitrary selection and could not be justified by calling it classification in the absence of real distinction of a substantial basis. The Court said:

> "While reasonable classification is permitted without doing violence to the equal protection of the laws, such classification must be based upon some real and substantial distinction bearing a reasonable and just relation to the things in respect to which such classification is imposed, and classification cannot be arbitrarily made without any substantial basis. Arbitrary selection, it has been said, cannot be justified

by calling it classification." (*Gulf, Colorado & Santa Fe Ry.* v. *Ellis*, 165 U. S. 150, 155, 165; *Cotting* v. *Kansas City Stockyards Co.*, 183 U. S. 79; *Connolly* v. *Union Sewer Pipe Co.*, 184 U. S. 540, 559."

While the case above cited arose under the Fourteenth Amendment to the Constitution of the United States, and while it was held that the complaining corporation was a citizen within the jurisdiction of the State of Alabama and entitled to the equal protection of its laws under that amendment, the case is an additional authority to many in this Court upon the proposition that while a legislative body possesses great powers in classifying subjects of taxation and imposing different rates of taxation upon different classes of subjects, the action of the legislature must be classification and not arbitrary selection. It is well said that the object of the Fourteenth Amendment was "to prevent any person or class of persons from being singled out as a special subject for discriminating and hostile legislation" (*Pembina Mining Co.* v. *Pennsylvania*, 125 U. S. 181, 188), but the principle of the Fourteenth Amendment that prevents this discriminating and hostile legislation is found in the implied limitations of the Constitution of the United States upon the taxing power of Congress. The power that is given to Congress is to levy and collect taxes, and amounts sought to be collected by legislation by the process of arbitrary selection and not by that of classification are not taxes, but arbitrary exactions and beyond the power of Congress to enforce. It has been frequently held that, notwithstanding the language of the Fourteenth Amendment in its guarantee of equal protection of the laws is not to be found in the Constitution of the United States, that its principle is an implied limitation on the powers of Congress, and that the Constitution of the United States by implication requires Congress

to see to it that in its legislation the citizens of the United States receive the equal protection of the laws of the United States.

While it is the function of the Legislature to classify, or to attempt to classify, for purposes of taxation, it is the function of the Court to inquire whether the result attained is classification or arbitary selection. As "such classification must be based upon some real and substantial distinction bearing a reasonable and just relation to the things in respect to which such classification is imposed and classification cannot be arbitarily made without any substantial basis," in the language of this Court (216 U. S. 417), it is the function of this Court to inquire whether any criticized classification is or is not based upon some real and substantial distinction, and whether such distinction does or does not bear a reasonable and just relation both to the things in respect to which such classification is imposed, and the nature of the legislative power to the exercise of which the classification is incident.

Conclusion.

Corporations, in their relation to income, are mere instrumentalities for getting income together and distributing it among those beneficially interested. On no other theory can the discrimination between corporations and individuals in respect to the surtax be justified. One tax on the income at any stage between its original accrual and final distribution is all that comes within the scope of a general income tax law such as the Sixteenth Amendment contemplates. The additional tax or taxes on income distributed through intermediate corporations, exacted by the Income Tax Law of 1913, are in substance and effect direct taxes upon the property from which the income is derived and therefore void for lack of apportionment. No ques-

tion of excise tax is involved because Congress has not attempted to impose any such tax and because the additional tax by its terms is not limited to corporations which do business in a corporate or organized capacity but extends to those which merely receive and distribute dividends (*McCoach* vs. *Minehill, etc., R. Co.*, 228 U. S. 295). The discrimination of which we complain was in fact aimed at corporations of the type last mentioned and would not have been introduced into the law except for the hostility with which they were regarded.

POINT THIRD.

The provisions of the statute which require collection at the source by corporations, debtors, fiduciaries and employers involve the taking of property without due process of law and the taking of private property for public use without compensation and are invalid.

The act of October 3rd, 1913, provides that all persons, corporations or associations acting in any fiduciary capacity shall make and render a return of the net income of the persons for whom they act coming into their custody or control; that all persons or corporations, in whatever capacity acting, having the receipt or payment of fixed or determinable annual or periodic gains, profits or income of any person subject to the tax shall on behalf of such person deduct and withhold from the payment an amount equivalent to the normal tax upon the same and render a separate

and distinct return of it, which return shall also contain the name and address of the person. They are required to pay the tax to the proper officers of the United States Government and are made personally liable therefor. The tax must be withheld from the income derived from interest upon bonds and mortgages or deeds of trust or similar obligations of corporations *whether payable annually or at shorter or longer periods, although such interest does not amount to three thousand dollars.* A fine and an addition of fifty per cent. to the tax are imposed upon the corporation or person neglecting to perform the above duties.

Paragraph D of Section 2 of the Act of October 3, 1913, contains various provisions with regard to the collection of the tax at the source. The method of such collection is prescribed by the following extract:

> " * * * guardians, trustees, executors, administrators, agents, receivers, conservators and all persons, corporations or associations acting in any fiduciary capacity shall make and render a return of the net income of the person for whom they act, subject to this tax, coming into their custody or control and management, and be subject to all the provisions of this section which apply to individuals; * * * and also all persons, firms, companies, copartnerships, corporations, joint stock companies or associations and insurance companies, except as hereinafter provided, in whatever capacity acting, having the control, receipt, disposal or payment of fixed or determinable annual or periodical gains, profits and income of another person, subject to the tax, shall in behalf of such person deduct and withhold from the payment an amount equivalent to the normal tax upon the same and make and render a return as aforesaid, but separate and distinct of the portion of the income of each person from which the normal tax has thus been withheld, and containing also the name and address of such person or stating that the name and address, or the ad-

dress, as the case may be, are unknown; * * * *Provided further* that in either case above mentioned no return of income not exceeding $3,000 shall be required:"

Paragraph E of the Act contains the following provision:

"All persons, firms, copartnerships, companies, corporations, joint stock companies or associations and insurance companies, in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, agents, receivers, conservators, employers and all officers and employees of the United States having the control, receipt, custody, disposal or payment of interest, rent salaries, wages, premiums, annuities, compention, remuneration, emoluments or other fixed or determinable annual gains, profits and income of another person exceeding $3,000 for any taxable year, other than dividends on capital stock or from the net earnings of corporations and joint stock companies or associations, subject to like tax, who are required to make and render a return in behalf of another as provided herein to the collector of his, her or its district, are hereby authorized and required to deduct and withhold from such annual gains, profits and income such sum as will be sufficient to pay the normal tax imposed thereon by this section and shall pay to the officers of the United States Government authorized to receive the same; and they are each hereby made personally liable for such tax. * * * *Provided further* that the amount of the normal tax hereinbefore imposed shall be deducted and withheld from fixed and determinable annual gains, profits and income derived from interest upon bonds and mortgages or deeds of trust or similar obligations of corporations, joint stock companies, or associations, and insurance companies, whether payable annually or at shorter or longer periods, although such interest does not amount to $3,000, subject to the provisions

of this section requiring the tax to be withheld at the source and deducted from annual income and paid to the government".

Paragraph F provides:

"F. That if any person, corporation, joint stock company, association or insurance company liable to make the return or pay the tax aforesaid shall refuse or neglect to make a return at the time or times hereinbefore specified in each year, such person shall be liable to a penalty of not less than $20 or more than $1,000."

Paragraph I provides for the Amendment of Section 3176 of the Revised Statutes of the United States, as amended, so as to include persons, corporations, companies or associations liable to make a return under the Federal Income Tax Act. This section provides that in case of the refusal or neglect, except in cases of sickness or absence, to make a list or return or to verify the same, the Commissioner of Internal Revenue shall add fifty per centum to the amount of the tax found by him upon an examination to be payable.

These provisions of the Act therefore impose upon the persons and corporations against whom the requirement is directed the obligations—

(*a*) To make a "return" to the proper Collector;

(*b*) To withhold the amount of the normal tax upon the payment made by them;

(*c*) To pay the tax so withheld to the proper Collector;

(*d*) Personal liability for the tax; and

(*e*) In the event of their failure "to make the return or pay the tax aforesaid" to pay a penalty of not less than $20 or more than $1,000, and an additional fifty per cent. of the amount of the tax.

These provisions impose upon certain persons and corporations, if they be fiduciaries, employers, tenants, or debtors paying interest periodically upon coupons or registered bonds or notes, onerous duties in regard to the collection and payment of the taxes of other persons. All these classes enumerated, whether they be corporations or individuals, besides paying their own taxes must ascertain which of the various forty-three "forms of return" issued by the United States Treasury Department is applicable, must keep books and accounts from which the details required by the form can be filled in, must prepare, verify and file the different returns after having computed the amount of the tax in each case which must be withheld.

Further, in the event that the beneficiary, employee, landlord or creditor claims the benefit of the statutory exemption of $3,000, or $4,000, a notice to that effect is filed with the fiduciary, employer, tenant or debtor, who then must not withhold the tax and must transmit the claim to exemption to the proper collector of internal revenue.

Concrete effect upon the defendant of provisions for compulsory service.

The bill alleges (Rec., p. 15):

> "Your orator avers, on information and belief, that the annual additional expense of the defendant corporation in connection with the performance of its duties of collection of income tax at the source, which involves the hiring of additional clerks, opening and keeping additional books of record, the making out of many documents and returns, additional bookkeeping, labor of various sorts, correspondence and other matters, will amount to the sum of at least between five and ten thousand dollars. That the purpose of the aforesaid requirements is to assist the Government of the United States in collecting the said income tax and to give to it in-

formation with respect to individuals liable to pay said tax. That compliance with such requirements imposes an additional burden upon this defendant and other corporations over and above the amount of any tax that can be levied and assessed upon them under the terms of said Act, and that the imposition of such burden is contrary to and violative of the Fifth Amendment to the Constitution of the United States and involves the taking of property without due process of law and the taking of private property for public use without compensation."

Invalidity of requirement for compulsory service.

A requirement by statute that services unknown to the common law shall be performed by corporations or citizens without compensation is the equivalent of a statutory requirement, taking arbitrarily and without due process of law and for public use without compensation, the property, real or personal, of the citizens. These propositions become more clear when we consider their application to the case of a corporation, like this defendant, which is incapable of performing services for the State, except through the acts of individuals who are its employees. The corporation which is called upon by the statute in question to perform gratuitous services for the Government in the collection of an income tax, has no means of compelling its individual employees to act in the service of the Government. It can only command those services by pecuniary rewards which deplete its resources. To the extent that the corporation in order to comply with the requirements of the Income Tax Law is forced to compensate its employees and to make other expenditures in the nature of stationery, rent, postage and other matters incidental to the transaction of the Government's business, to that extent the resources of the corporation are depleted and its property is taken for public use without due process of law and without compensation. The vital

question is whether the application by the Income Tax Law of the resources of private corporations, as well as those of fiduciaries, debtors and employers, to the public service and without compensation, is a lawful exercise of the power of taxation. Does the Sixteenth Amendment, in conferring upon Congress the right to tax income from whatever source derived, involve the conclusion that for the purpose of collecting such tax the private property of corporations and individuals can be applied without compensation to the public use? Can the convenience of the Government be made the basis of a classification of persons from whom gratuitous services unknown to the common law and involving the expenditure of money are to be exacted? If so, the way is open to take private property for public use without compensation whenever the convenience of the Government demands it. The effect of the Income Tax Law is to create corporations, debtors, fiduciaries and employers, assessors and collectors of the Income Tax, and not only to require the personal services of individuals but also the expenditure of such amounts of money as are necessarily involved in the performance of those services. Such services are wholly unknown to the common law and form no part of our system of relations between the citizens and our national government in view of the protection afforded by the Constitution of the United States. Corporate fiduciaries especially, acting in many trusts for many beneficiaries, are under the necessity of augmenting their office force. The burden of collecting and paying the taxes of large groups of persons falls directly and finally upon these corporate fiduciaries, for they cannot collect the expense thereof from their beneficiaries, as their compensation is almost universally limited by the state statutes which authorize their appointment.

Similar duties in regard to collecting taxes are

placed upon employers of persons whose individual salaries exceed the sum of three thousand dollars per annum. Perhaps in no case, however, does the oppressiveness of the burden and expense appear more clearly than in the case of corporations having outstanding bonded or other indebtedness upon which interest is paid. Frequently such payments are made through the medium of a fiscal agent—usually a bank or trust company—and in such cases the labor and expense falls upon the fiscal agent as well as upon the debtor corporation. Under the regulations of the Treasury Department the holders of bonds or other evidences of indebtedness are required to attach to their coupons representing the interest payable thereon "certificates of ownership" of prescribed forms. Before paying the interest due the fiscal agent must ascertain that the "certificate" attached is in proper form as required by the Treasury regulations and must determine at its peril whether on the statements made therein the tax should or should not be deducted on the amount of the interest payable. The fiscal agent must regularly report to the debtor corporation the gross amount of the tax withheld and deliver to it the "certificates of ownership." The debtor corporation in turn must make a return to the Collector of Internal Revenue of its district and list each of the "certificates of ownership" received from its fiscal agent, giving the names and addresses of the persons from whom the tax was withheld and of those from whom the tax was not withheld. Such returns are required to be made monthly.

Where the income is derived from interest upon bonds and mortgages or deeds of trust, no matter how small the amount or how often it is payable, if exemption be not claimed, the tax thereon must be deducted and with the prescribed report must be turned over to the government authorities.

This method may succeed in collecting the tax,

but it is obvious that it entails an expense in time and labor upon the third parties, neither taxed nor taxing, which must often exceed the amount realized. The intricate labor of collecting data, rendering reports and turning over multitudinous and frequently small sums of money is performed directly for the benefit of the United States government. The employers, corporations, debtors and fiduciaries are constituted its tax collectors, but far from providing for their reasonable compensation, their labor is enforced under threat of fine and penalty.

Inapplicability of prior decisions regarding collection at the source.

The matter of collection at the source has been treated incidentally in several cases arising out of the previous income tax laws, but in none of these was any constitutional question raised in opposition to the validity of this method of collecting the tax. Examples of such cases are the following:

> *Haight* v. *Railroad Company*, 6 Wall. 15.
> *United States* v. *Railroad Company*, 17 Wall. 322.

An examination of the cases in which the courts have treated this subject discloses that in no case has the complaining corporation found the burden so great as to lead to its resistance of the performance of the duties imposed upon it by Congress upon the grounds herein set forth.

The method is herein objected to in that it necessitates substantial labor and expense for the public benefit without providing any compensation.

It is of course true that this general plan of providing that the tax due by one is to be reported and paid by another is to be found in other statutes and has had the approval of this Court (*National Safe Deposit Company* v. *Stead*, 232 U. S. 58, p. 70).

Applied to certain situations, the plan entails little hardship and any modicum of expense necessitated may be passed over on the theory of *de minimis non curat lex.*

An examination of the brief in *National Safe Deposit Company* v. *Stead* (*supra*), shows that it was not contended that the Illinois inheritance tax placed a financial burden on the safe deposit company nor was such situation passed upon by this court.

In the case at bar it cannot be said that the statute does not result in a deprivation of property without due process of law and a taking of private property for public use without just compensation in violation of the Fifth Amendment. The allegations of the bill above quoted show that the pecuniary burden placed upon the defendant by the requirements above quoted amounts at least to between five and ten thousand dollars a year. Such deprivation cannot be ignored as one of the trivial things concerning which the law has no care. Five thousand dollars at the least represents the entire yearly labor of one skilled accountant. A man conducting a business through the controlling interest in such a corporation as defendant is accordingly by this statute placed in a position where he has a choice of working solely for the United States Government, year in and year out, the rest of his life, without a cent of compensation, or of hiring other persons to do such work for him. He is confronted with such life labor or the necessity of hiring a substitute. As a matter of fact, the actual situation is even more extreme, for the yearly labor of no one man can perform the obligations which this statute casts upon the defendant in the case at bar. And from the standpoint of the plaintiff defendant's funds are being dissipated in a labor which brings defendant no return.

Inapplicability of decisions in respect to the police power.

In *Atlantic Coast Line* v. *Goldsboro*, 232 U. S. 548, this Court, at page 558, stated that the enforcement of uncompensated obedience to a regulation established under the police power exercised for the public health or safety was not an unconstitutional taking of property without compensation or without due process of law, but added that the *regulation must be designed to promote the health, comfort, safety or welfare of the community* and that the means employed must have a real and substantial relation to such avowed or ostensible purpose. It cannot be contended that the expenditure necessitated by collecting the tax at the source is designated to promote health or comfort or public safety.

No pretense is made that the employers, fiduciaries, debtors, trust companies or various corporations are regulated in any way for the public health, comfort or safety. It is clear that the scheme has no ulterior motive of management of business for these kinds of public benefit. The sole object of this part of the act is to obtain a collection of the tax through the unrequited labor of private parties.

Unapportioned compulsory service is not a tax.

It is equally clear that the labor necessitated by this plan of collection is in itself not a tax. Essentials of a tax are that it must be definite and generally imposed upon all of a class, with substantial equality upon all the members of each class. This burden varies with each person or corporation. It is nothing to one, a small amount to another, it is solely labor to another, it is a larger amount to a fourth. Moreover, it is a burden of labor, not a pecuniary burden, except as labor may be hired by him who is charged, whereas the characteristic element of a tax is that it is a *pecuniary* burden. The

most frequent definition is, "a pecuniary burden imposed for the support of the government" (*U. S.* v. *The Railroad*, 17 Wall. 322, at 326; *In re Farrell*, 212 Fed. 212, at 213; *Mayor* v. *Cooper*, 131 Ga. 670, at 674; *Bouvier's Law Dictionary*). It is sometimes defined as a pecuniary burden laid upon individuals or property to support the Government (*New Jersey* v. *Anderson*, 203 U. S. 483). This indefinite and varying burden, not being pecuniary in character and resulting in a financial measurement only when the person or corporation is under the necessity of hiring some one to perform it, can accordingly find no justification as an exercise of the federal taxing power.

Nor does its performance fall within any of the heads of recognized duties of a citizen such as military, jury or fire duty or service as a member of a *posse comitatus*. This obligation does not fall upon the general body of citizens but upon a restricted class, and of course nothing is necessary beyond mere statement to prove that the obligation placed upon one citizen to collect and turn over the tax imposed upon a second citizen is a duty unheard of at common law.

In *Toone* v. *The State*, 178 Ala. 70, a statute of Alabama, approved the fourth of March, 1911, declared all horses, mules, wagons, plows, etc., in the county to be subject to road duty. The court, at page 66, stated that the requirement that citizens should work upon the public road in person or by a substitute, with the authorization of a fixed sum by way of commutation, did not constitute taxation but was the execution of a public duty of the same general class as militia duty; that it seemed to be a mere personal obligation from the subject and did not entail upon him the duty of furnishing his property in connection with his personal service. The court further stated:

> "The books have been examined in vain for an authority which will authorize the exaction

> from a citizen of the contribution of his property for public service under the theory that it is his duty as a citizen to contribute."

The obligation in the case at bar falls most heavily upon corporations. The work, of course, must be performed through their agents. We do not think the novel proposition will be advanced that it is the duty of a corporation as a citizen to hire labor for the assistance of the United States Government in the collection of its taxes.

Nothing in the Sixteenth Amendment justifies or contemplates any such method of tax collecting. There is no intention displayed in said amendment that the collection of taxes on incomes shall be other than through ordinary methods of tax collection or shall in any way abrogate the constitutional guarantees of freedom of property from confiscation.

It is submitted that the Fifth Amendment providing that no person shall "be deprived of life, liberty or property without due process of law; nor shall private property be taken for public use without just compensation," is herein violated.

Provision for just compensation essential.

That enforced labor by legislative enactment without compensation is an unconstitutional taking of property was recently held by this Court in *Louisville, etc., R. R.* v. *Stockyards*, 212 U. S. 132. In that case a section of the constitution of Kentucky provided that all railroad companies should receive, deliver, transfer and transport freight from and to any point where there was a physical connection between the tracks of two companies. This Court, per HOLMES, *J.*, held that the section was unconstitutional, at page 144, saying:

> "There remains for consideration only the third provision of the judgment which requires the plaintiff in error to receive at the connect-

> ing point and to switch, transport and deliver all livestock consigned from the Central Stockyards to any one at the Bourbon Stockyards. This also is based upon the sections of the Constitution that have been quoted. If the principle is sound every road in Louisville by making a physical connection with the Louisville & Nashville can get the use of its costly terminal and make it do the switching necessary to that end upon simply paying for the service of carriage. The duty of a carrier to accept goods tendered at its station does not extend to the acceptance of cars offered to it at an arbitrary point near its terminus by a competing road for the purpose of reaching and using its terminal station. *To require such an acceptance from a railroad is to take its property in a very effective sense* and cannot be justified unless the road holds that property subject to greater liabilities than those incident to its calling alone."

A destruction of property for public purposes is as complete a taking as would be its appropriation for the same end (*U. S.* v. *Welch*, 217 U. S. 333, at 339).

When the statute has forced upon defendant an obligation, to perform which an expenditure of from five to ten thousand dollars has been necessitated, the statute in effect has taken from defendant the amount actually expended. The Government has had the benefit of labor of that value, and if there be no obligation to compensate defendant, has deprived it of that amount.

In *U. S.* vs. *Buffalo Pitts. Co.*, 234 U. S. 228, the plaintiff sold a traction engine to a government contractor retaining thereon a chattel mortgage. The contractor failed and the Government took over his property including the engine. This Court held that the Government had no right to use the property of others without compensation, at page 235, saying:

> "While the government claimed the right thus to take and use the property, it never-

> theless held it without denying the right of the owner to compensation. When it takes property under such circumstances for an authorized governmental use it impliedly promises to pay therefor. This accords with the principles declared in the previous cases in this court and arises because of the constitutional obligation embodied in the Fifth Amendment to the Constitution of the United States guaranteeing the owner of property against appropriation for a governmental use without compensation."

In *Richards* v. *Washington Terminal Co.*, 233 U. S. 546, this Court, at page 552, pointed out the distinction between the power of Parliament, omnipotent so far as authorizing the taking of private property for public use without compensation to the owner, and the power of the Federal Congress, the legislation of which must conform to the Fifth Amendment.

In *James* v. *Campbell*, 104 U. S. 356, there was involved the right of the United States to use a patented article—a stamping device—without making compensation to the holder of the patent. Mr. Justice BRADLEY, delivering the opinion of the Court, at page 358, stated:

> "The United States has no such prerogative as that which is claimed by the sovereigns of England, by which it can reserve to itself, either expressly or by implication, a superior dominion and use in that which it grants by letters patent to those who entitle themselves to such grants. The government of the United States, as well as the citizen, is subject to the Constitution; and when it grants a patent the grantee is entitled to it as a matter of right and does not receive it as was originally supposed to be the case in England as a matter of grace and favor."

In the case at bar it makes little difference whether the defendant is forced to perform labor

for the government, for its rival in business or for various groups of taxpayers. The vice of the legislation is that labor is enforced without compensation being provided. The government has no more right to take this enforced labor than it has to turn over the results of it to some private citizen.

In *Chicago, Burlington, &c., Railroad* v. *Chicago*, 166 U. S. 226, this court, at 236, said:

> "But if, as this court has adjudged, a legislative enactment assuming arbitrarily to take the property of one individual and give it to another individual, would not be due process of law as enjoined by the Fourteenth Amendment, it must be that the requirement of due process of law in that amendment is applicable to the direct appropriation by the State to public use and without compensation of the private property of the citizen. The legislature may prescribe a form of procedure to be observed in the taking of private property for public use but it is not due process of law if provision be not made for compensation."

It is no answer to this proposition to assert that due process of law is necessarily involved in any exercise of the taxing power. As above shown, this is not a tax but enforced labor in tax collection. It requires corporations and others to turn over the use of their property and to make expenditure for the benefit of the government, without compensation or reimbursement.

In *Lake Shore* v. *Smith*, 173 U. S. 684, the legislature of Michigan had established certain maximum railroad rates, but nevertheless assumed to provide an exception in favor of those able to purchase tickets at wholesale rates, at the same time lengthening the period during which such tickets should be valid. The Court, at page 691, said:

> "It thus invades the general right of a company to conduct and manage its own affairs and

> compels it to give the use of its property for less than the general rate to those who come within the provisions of the statute and to that extent it would seem that the statute takes the property of the company without due process of law."

Somewhat analogous pieces of legislation have been held unconstitutional.

In *McCully* v. *The Railroad*, 212 Mo. 1, a law provided that whenever a railroad company should receive or ship any livestock, said railroad in consideration of the usual price paid for the shipment of the car, should pass the shipper or his employee to and from the point designated in the bill of lading, without extra expense. The Court held that the act resulted in a discrimination in favor of the shipper of livestock by the railroad, as against the shipper of other classes of freight, and that the act was unconstitutional in that it deprived the carrier of its property without due process of law, in violation of the Fourteenth Amendment.

In *Attorney-General* v. *Old Colony Railroad*, 160 Mass. 62, an act required railroads to provide mileage tickets, good upon all railroads of the commonwealth. The Court, at page 89, said:

> "The most formidable objections are that the statute authorizes one railroad to determine the conditions under which another railroad must carry passengers and compels one railroad to carry passengers on the credit of another. We have been referred to no judicial decision where any such legislation has been considered.
>
> The law governing the taking of private property for public use affords some analogies which we think are applicable to the present cases. * * * The statute authorizing the taking must contain some provision for obtaining adequate indemnity. It is not enough to leave the owner to his action at law for damages. * * * *If this is true when the property taken is land, much more it is true when the property taken is*

consumed in the use so that if compensation is not ultimately paid the owner has no remedy by taking back the property. When property is taken for a public use and is consumed in the use provision for adequate compensation certainly ought to be more than a mere right of action against a private person or corporation with the risk of never obtaining satisfaction and the compensation when it is made must be made in money."

In *Chicago, Milwaukee & St. Paul Railway Co. v. Wisconsin*, 238 U. S. 491, it appeared that the State of Wisconsin had imposed a penalty on sleeping car companies if the lower berth of a sleeping car was occupied and the upper berth was let down before it was actually engaged. This statute was held to be unconstitutional under the due process clause of the Fourteenth Amendment and an arbitrary taking of property without compensation. It was also held that it could not be justified either as a health measure under the police power of the State, or as an amendment of the charter of the corporation. The Court held that notwithstanding the right of the State to regulate public charters in the interest of the public was very great, that great power did not warrant an unreasonable interference with the right of management or the taking of the carrier's property without compensation. The Court said:

> "For as the state could not authorize the occupant of the lower berth to take salable space without pay, neither can the present statute compel the company to give that occupant the free use of that space until it is actually purchased by another passenger. The owner's right to property is protected even when it is not actually in use and the company cannot be compelled to permit a third person to have the free use of such property until a buyer appears."

Of course, if Congress had determined that to meet the expense of the collection of the income

tax each corporation should contribute a varying amount of money or of its real estate and, in the case of the defendant, that either ten thousand dollars in cash or a parcel of land of the value of ten thousand dollars be given, there would be no dispute but that the law would be unconstitutional, but, it follows from the reasoning of the cases just cited, that the fact that the property here taken consists in labor or in money expended to hire labor used up in the service of the government does not in any sense justify the sacrifice demanded of defendants. The admission on the record that it is of a value between five thousand and ten thousand dollars gives it a character as definite as a parcel of real estate of the same value.

In *United States* v. *Mitchell*, 58 Fed. 993, the provision of the Act of July 6, 1892, imposing a penalty for refusal to answer questions upon officers of corporations engaged in productive industry was held ineffective because there was no provision in that or any other act requiring such corporations to answer the questions. On demurrer to the indictment it was urged that the furnishing of the answers to the questions involved a taking of property for which no compensation was made. The Court suggested that there might be a limit to the power of Congress to compel a citizen to disclose information concerning his business undertakings, and at page 999 said:

> "This limit must relate not only to the kind of information he may properly refuse to disclose, because it may be equivalent to the appropriation of private property for public use without just compensation, but also to the extent of the information required, as well as to the time within which it shall be given. Certain kinds of information valuable to the public, and useful to the legislative branches of the government as the basis for proper laws, have heretofore been voluntarily given, and may properly

> be required from the citizen, when it is not of property value, or when the collection, compilation, and preparation thereof does not impose great expense and labor for which compensation is not provided. It is not infrequent, however, that answers to questions propounded in some schedules, if fully and properly prepared, involve the collection and compilation of facts that require the labor of a large force of clerks for days and weeks, entailing great expense and embarrassment to the ordinary business of the citizen. Is it within the power of Congress to make such answers compulsory and require the citizen to neglect his usual business with loss and to prepare this information at a great personal expense without proper compensation? * * * As before stated, when such information is required as the basis for proper legislation or the just enforcement of the public laws, the power to compel its disclosure may exist and if unusual expense attends its preparation, proper remuneration to the citizen can be made."

The demurrer to the indictment was then sustained.

In the case at bar the entire absence of compensation is noteworthy. In *Merchants Bank* v. *Pennsylvania*, 167 U. S. 461, the state statute gave banks an election to collect and pay the tax on the stockholders' shares but in return for such collection the bank received certain exemptions from local taxation.

In *Consolidated Rendering Co.* v. *Vermont*, 207 U. S. 541, the Company was served with a notice to produce certain books and papers before the grand jury sitting at Burlington, in Vermont. The Company was doing business in that city. It produced certain books but failed to produce others. One of the grounds urged as an excuse was that certain books and papers had been sent on to Boston, Massachusetts, and that the collecting and sending on of the documents involved expense. The legislation, however, was sustained on the

ground that compensation in the nature of witness fees was provided by the general law of the State.

There is no such element which may be urged in defense of the present statute. No question of reasonableness of compensation arises. No compensation whatsoever is provided.

Congress in the exercise of its taxing power is nevertheless bound by the express and implied provisions of the Constitution. In *Connolly* v. *Union Sewer Pipe Co.*, 184 U. S. 540, the Court, at 563, said:

> "On the contrary, the power to tax is so far limited that it cannot be used to impair or destroy rights that are given or secured by the supreme law of the land."

The Act not only exacts labor without compensation but exposes the defendant to unnecessary risks and perils.

One inevitable result of the provisions of the Act of October 3d in respect to collection at the source is that such a corporation as this defendant will necessarily pay to the Government a considerable amount of money as a tax upon coupons or interest on registered bonds which the Government is not entitled to, and which practically never can be recovered back from the Government. The statute requires such tax to be paid, notwithstanding that the income of the debtor of the corporation may be less than $3,000. The bill sets out that, with respect to many of its issues of bonds, this defendant corporation has agreed to pay to the Government any tax which it may be required by law to withhold from the bondholders. With respect to such bonds, therefore, as to which this contract has been made by the defendant, the taxpayer will receive his interest in full without diminution and the corporation will withhold and pay the normal tax of one per cent. upon that interest to the Government.

Many of these bondholders may be entitled to the exemption of $3,000 or $4,000 provided for by the statute, but, practically, they will never claim that exemption to the defendant corporation because the making of such a claim would involve a certain amount of trouble and be of no pecuniary benefit to the claimant, who will receive his interest in full from the defendant. The corporation is, therefore, left in the position of having paid an Income Tax on behalf of bondholders who might claim the exemption and who are not liable under the Act by reason of their incomes not reaching the amount of $3,000. The corporation has no means of ascertaining whether its bondholders are exempt or not, except by the expenditure of considerable money in compensating individuals to make investigations and collect evidence. It is no answer to say that the defendant should go to the necessary expense to find out whether its bondholders are or are not exempt and has the privilege not to pay the tax to the Governernment on behalf of such bondholders who are entitled to the exemption. The burden of defendant's complaint is that the Government throws upon it great expense in connection with the collection of taxes not of defendant but of its bondholders. The practical effect of the statute, therefore, in requiring the defendant to collect and pay the taxes of its bondholders is to inflict upon the defendant corporation in any event considerable pecuniary loss, whether that loss be in the payment of taxes to which the Government has no legal claim or in ascertaining the facts, the existence of which would justify the corporation in not paying any taxes for its bondholders.

Surely, the property of a corporation is taken for public use and without compensation when the inevitable operation of a statute is either to compel the corporation to pay taxes that are not lawfully due, or to conduct an expensive and inquisitorial

investigation into the private affairs of third persons. It is to be noticed that the statute does not exempt the corporation from withholding and paying the tax upon interest in the event that the person entitled thereto is actually exempt, but only in the event that the person entitled thereto files with the corporation debtor a claim to exemption. It is also to be noted that the statute does not protect such a corporation as this defendant, which has contracted to pay all taxes upon interest which are required by law to be withheld, by making it obligatory upon the bondholders to claim to the debtor corporation an exemption from the Income Tax Law to which he may be entitled, and it is perfectly obvious that no bondholder will go to the trouble of claiming an exemption simply for the purpose of protecting his debtor corporation from an exaction on the part of the Government of a tax on the interest when the bondholder is sure to receive his interest in full without making a claim to exemption.

The Act involves unreasonable discrimination and arbitrary classification.

The practice of collection at the source involves various discriminations between taxpayers that are unreasonable, founded simply upon the convenience of the Government, and bear no just relation to the subject matter involved. Among others may be mentioned these:

1st. A discrimination is made that involves a heavier burden of expenditure upon corporations who are indebted upon bonds or obligations for the payment of money than that placed upon those who are not so indebted.

2nd: A discrimination is created that involves a heavier burden of expenditure upon corporations

who have funded their debts in favor of corporations whose only indebtedness is of a floating character, the interest upon which is not payable at fixed periods.

3rd: A discrimination is effected that involves a heavier burden of expenditure upon individuals who are fiduciaries or employers than that placed upon those who do not occupy those relations.

There is no reasonable classification for purposes of taxation between individuals who are fiduciaries and employers and those who are not. The only basis for these classifications or discriminations is the convenience of the Government and the saving to it of expense in assessing and collecting its taxes.

An incidental effect of the system of deduction and collection at the source is the deprivation to individuals of the use and benefit of the moneys withheld to pay their taxes during the period of time between the date of the withholding and the date of the assessment of said tax or the payment of the tax.

The following extract from a paper read by Professor Charles J. Bullock, of Harvard University, at the Eighth Annual Conference of the National Tax Association is illuminating:

> "The difficulty is greatest in the case of interest on corporation bonds and other obligations since a very large proportion of these securities consist of coupon bonds, and the tax must be deducted from all payments whatever their amount. In some sections of the country the larger city banks have made arrangements by which country banks have been relieved of trouble and expense in connection with the tax, but this concentrates the burden rather than diminishes it. I am informed that one banking institution has been put to an additional expense of $15,000 per annum, and another to an

expense of $20,000. These figures are exclusive of the heavy initial cost the system entailed, and represent what is likely to be the normal outlay for these institutions. If data could be secured for the entire country the total burden would surely be impressive.

Even worse than the absolute amount of the expenditure is its relation to the amount of the tax actually paid the government. The institution that is spending $15,000 will have collected at the end of the first year $53,000 of income tax upon corporation bonds, the cost of collection amounting to nearly thirty per cent. A traction company collected $8,200 of tax between November 1, 1913, and February 1, 1914, and spent $3,299 in performing this service. Here the cost of collection rises to forty per cent. Another public service corporation collected $9,821 of tax up to August 1st, and expended $7,011 in so doing, the cost of collection amounting to over seventy per cent., but these figures may include initial outlays that will not recur. I can find no reason for thinking these cases exceptional, and they merely confirm the general opinion prevalent among those conversant with the facts, that the cost of collecting the tax on bond interest at the source is absurdly, preposterously high. The cost of collecting the customs revenue of the United States is about three and one-half per cent., and the internal revenue of 1911 cost but one and one-half per cent. The Wisconsin income tax showed a net cost of collection 1.28 per cent. in its first year. In general any tax that costs more than five or six per cent. to collect is uneconomic, and most taxes cost much less than this figure. But in respect of bond interest the government of the United States is now collecting an income tax at an expense of from thirty to forty per cent.—to other people.

My contention is, then, that collecting the income tax at source has largely changed its incidence, lowered its moral, and in some cases resulted in a preposterously high cost of collection which the government throws upon private citizens and corporations without compensation."

At the discussion which followed the reading of the above and other papers Dr. E. R. A. Seligman said (Papers and Discussion on the Federal Income Tax, Reprinted from proceedings of the Eighth Annual Conference of the National Tax Association, p. 56):

> "As I may be considered in a certain sense responsible for having foisted upon the government this principle of collection at source, I feel that a few words ought to be said on that point in order, if possible, to minimize some of the objections that have been alleged. I do not think that all of the objections can be removed. There are certain undeniable defects in the law. Whether one believes in the principle of collection at source or not, I think everyone would agree that it is unjust to put the expense of what is properly a governmental function upon individuals or the corporation. That, however, is a detail which can be remedied without abandoning the principle itself; and it ought to be remedied if the principle is retained."

Conclusion.

No attack is made herein upon the principle of collection at the source. It is conceded that it is for the Congress to determine whether that method of collecting the income tax shall be employed, provided due compensation is made to those who furnish labor and money to the Government in the assessment and collection of the tax. It is urged that it is the part of the Court to determine whether the requirements of the Government upon its citizens in the collection of the tax involve violations of the constitutional provisions, and should it be found that such violations have occurred, doubtless Congress in its wisdom will find a way to retain all the useful provisions of collection at the source, coupled, however, with due compensation to the assessors and collectors of the tax.

POINT FOURTH.

The statute is invalid in the particular of seeking to tax income received prior to October 3rd, 1913.

Section D of the Income Tax Law is as follows:

> "The said tax shall be computed upon the remainder of said net income of each person subject thereto, accruing during each preceding calendar year ending December thirty-first; provided, however, that for the year ending December 31st, 1913, said tax shall be computed on the net income accruing from March first to December thirty-first, 1913" * * *

The Act became a law October 3rd, 1913. It purports, therefore, to reach back and tax amounts received as income prior to the time of its passage from March 1st, 1913.

The Sixteenth Constitutional Amendment authorized a tax on *income* without apportionment. In regard to all other direct taxes Congress is still bound by the constitutional requirement that they be apportioned.

The Pollock case (158 U. S. 601) decided that a general tax upon the income of real and personal property was a direct tax, within the meaning of that term as used in the Constitution, upon the real and personal property that produced the income, and could not be levied without apportionment. This case obliterated any distinction between income as such and the property that produced the income, regarded as subjects of taxation. It established the proposition that an income tax is one that reaches income producing property through the method of assessing or valuing it by its income producing effectiveness. The Sixteenth Amendment left every

direct tax upon real and personal property still subject to the requirement of apportionment, except such a direct tax as might be collected by the operation of a law of Congress that established a tax to be collected by the method of assessing or valuing the taxed real and personal property by its income.

It is clear that the Sixteenth Amendment was itself not legislation. It was merely permissive in character. It was a grant not an exercise of taxing power. Congress could exercise the power or decline to do so as its wisdom might decide. The Amendment was not self operative, and no tax was imposed until the power conferred was exercised by the passage of the Act of October 3, 1913. Analagous to the effect of the grant to Congress in the Constitution to pass uniform laws on the subject of bankruptcy, the power to tax incomes was dormant.

This principle was clearly stated in *Sturges* v. *Crowninshield*, 4 Wheat. 122, wherein it was held that a state had power to pass an insolvency law provided there was no act of Congress in force at the time on the subject.

MARSHALL, *Ch. J.*, at page 195 said:

> "It does not appear to be a violent construction of the Constitution, and it is certainly a convenient one, to consider the power of the States as existing over such cases as the laws of the Union may not reach, but be this as it may, the power granted to Congress may be exercised or declined as the wisdom of that body shall decide. If in the opinion of Congress uniform laws concerning bankruptcies ought not to be established, it does not follow that partial laws may not exist or that state legislation on the subject must cease. It is not the mere existence of the power but its exercise which is incompatible with the exercise of the same power by the States. It is not the right to establish these uniform laws but their actual establishment which is inconsistent with the partial acts of the States.

"It has been said that Congress has exercised this power; and by doing so has extinguished the power of the States which cannot be revived by repealing the law of Congress.

"We do not think so. If the right of the States to pass a bankrupt law is not taken away by the mere grant of that power to Congress, it cannot be extinguished; it can only be suspended by the enactment of a general bankrupt law. The repeal of that law cannot, it is true, confer the power on the States; but it removes a disability to its exercise which was created by the Act of Congress."

In *Missouri Pacific Ry. Co.* v. *Larabbee Mills*, 211 U. S. 612–623, it was held that even where Congress had already acted and had given to the Interstate Commerce Commission a large measure of control over interstate commerce, in the absence of action by the Commission, the authority of the State in merely incidental matters remains undisturbed.

See also *Minnesota Rate Cases*, 230 U. S. 352–398.

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The principle of these cases, and of the numerous decisions referred to in their reported opinions, is that the grant of power to Congress by the Constitution does not become effective until Congress exercises the power by legislation.

So until the 3rd of October, 1913, there was in existence no law of Congress on the subject of taxation of incomes or property producing income. The power of Congress to tax incomes or income producing property without apportionment prior to that day was dormant.

In permitting real and personal property to be taxed directly without apportionment, the Sixteenth Amendment limited such taxation to the single method of measuring the value of the property by its income. It follows that at the time the power

to tax comes into existence, the measure of value must then be "income," not that which has been and is not then "income."

When on the 3rd of October, 1913, the power was exercised, the question arises whether, in taxing amounts received as income since March 1st, 1913, without apportionment, the statute has kept within the limitations of the constitutional amendment that gave only power to tax *income*.

That power was one to tax the real and personal property that produced the income, and could only be exerted to cover a period subsequent and not prior to its exercise.

Prior to October 3d, 1913, real and personal property producing income were as free from any liability to the payment of a tax based on income as if the Sixteenth Amendment had not been passed. The second section of the Tariff Act in taxing real and personal property directly and without apportionment for the period from March 1, 1913, to October 3d, 1913, assessed or valued by its income is ineffective because that method of taxation had not been created by Congress until October 3d, 1913. Prior to that date it was not in existence and was prohibited by the provisions of the Constitution above set forth.

This is a matter of the construction of the Sixteenth Amendment and the meaning to be given to the word "income." The measure of the value of the property to be taxed must be "income" during the period within which this method of taxation exists. Prior to October 3d, 1913, that which was income subsequent to March 1, 1913, had ceased to be income, and therefore could not be taken as a measure of value of real and personal property to be taxed directly without apportionment.

The problem is as to the status of amounts already received as income prior to the time of the passage of the act. No question of doubt as to the intention

on the part of Congress is presented. It intended to tax directly the property that had produced the income received by the taxpayer between March 1st, 1913, and October 3rd, 1913, without apportionment. No legislative *fiat* of October 3rd, 1913, however, could change what already existed. Such amounts as had been received by the taxpayer prior to that date were no longer income but had become capital and merged in the general *corpus* of his estate.

The distinction between income and capital is plain.

In *Merchants' Ins. Co.* v. *McCartney*, 1 Lowell, 447, plaintiffs, as stockholders in the Suffolk Bank, received an extra dividend declared by the bank on the 3rd of January, 1865. The defendant, as tax collector, acting under the income tax law of June 30th, 1864, collected from plaintiff a tax on the whole amount received by them. But of the dividend declared by the bank, about three-tenths consisted of profits laid aside before the passage of the first internal revenue law. On the remaining seven-tenths the plaintiffs paid the tax.

LOWELL, *D. J.*, said:

> "As to the three-tenths it seems to me to have been a division of capital, a return to the plaintiffs in money of a part of the property which was already in their ownership as capital stock when the first tax was passed. If the Suffolk Bank had been wholly wound up, and had returned to its stockholders the exact value of their shares in money, having made no profits since the passage of the original act, this sum could not be taxed as income, gains, or profits; and so of a part. If the plaintiffs on receiving the money chose to divide it among their own stockholders, still it is not a dividend out of gains and profits, nor out of the surplus funds, because the surplus funds that are taxable, are those which are or have been made out of profits, since the passage of the act. This view ap-

> pears to have been acquiesced in by the Government, for they have neglected for some five years to enforce the opposite construction against the bank; and if this money was capital in the hands of the bank it was still capital when it reached the stockholders. The tax is assessed on the bank for convenience, but is intended to be, in effect, a tax on the shareholders; and if the latter be not assessable for the income tax it cannot be levied on the corporation."

Further on, in his opinion, the learned Judge stated that in drawing the above conclusion he had not referred to a certain section of the revenue act, "because it seemed to me the result was the same *upon any fair meaning of the word income.*"

In *People ex rel. Cornell* v. *Davenport*, 30 Hun, 177, the Court, at page 177, defining income, said:

> "The income from an investment is that which it earns, remaining itself intact."

Income is that which comes or is coming in, not that which has come in. It exists only during a period of transition. The Century Dictionary defines it as

> "A coming in; arrival, entrance; introduction. * * * That which comes in to a person as payment for labor or services rendered in some office or as gains from lands, business, and investment of capital, etc. * * *"

In *Sun Mutual Ins. Co.* v. *The Mayor*, 8 N.Y. 241, the plaintiff had accumulated certain profits. Action was brought, among other things, to restrain the collection of taxes thereon. The Court held that the accrued income constituted capital and was subject to the tax.

Prior to October 3rd, 1913, income was not lawfully a measure of value of real and personal property to be taxed directly by Congress without apportionment. The taxing power had not been

exercised with respect to that matter. Income rereceived prior to October 3rd was free from taxation or more properly, free from service as a measure of value of property, when received. All amounts received by the taxpayer prior to October 3rd, 1913, came into his hands free from any burden of taxation that had been imposed by Congress upon it or upon the property that had produced it. That burden could not be imposed by legislation enacted subsequently to its receipt. Clearly the property, real and personal, that produced that income was not subject to taxation without apportionment prior to October 3rd, 1913, or for any period prior to that date.

Income may be received either in cash or in property. It can only be income once and that is at the moment of its receipt. Before that moment it is mere expectation; afterwards it is an increment to capital. Therefore, a power to tax income can be exercised only by taxing it at the moment when it comes in. If not then subject to taxation the opportunity of taxing it cannot be revived by any legislative action because the legislature cannot take a portion of a man's capital and reconvert it into income by a statute. Immediately upon its receipt income loses its distinctive character as such and becomes part of the *corpus* and capital of an estate. Whether, therefore, the attempt to tax income received prior to October 3rd, 1913, be regarded as a tax on the real or personal property that has produced the income or on the kind of property in which the income is paid, there is an attempt to collect a direct tax upon real and personal property without apportionment for a period for which no valid tax has been imposed by Congress.

The Sixteenth Amendment did not confer the power to tax persons with respect to incomes earned or received in the past, or to tax property by reason

of the fact that at some time previous to the exercise of the taxing power, it had produced income. The Amendment only purports to confer the power to tax property in the act of producing income valued by that income. In other words, the Amendment conferred no power of retroactive legislation, but only the power that Congress might enact a statute to reach property valued by receipts at the time such receipts were income.

That gains in years past are not properly the income of the present was held in *Gray* v. *Darlington*, 15 Wall. 63, wherein plaintiff in 1865 had obtained certain United States bonds. In 1869 he sold them at an advance of $20,000. The collector levied a tax upon this amount, claiming that it constituted "gains, profits and income" for the year 1869.

The Court, however, held that it was an increase of capital, at page 66 saying:

> "The rule adopted by the officers of the revenue in the present case would justify them in treating as *gains of one year* the increase in the value of property extending *through any number of years*, through even the entire century."

In construing the provisions of a constitution or constitutional amendment it should be borne in mind that such instruments are really the work of the people. Although subject to ratification by State Legislatures, the adoption or rejection of an amendment to the Constitution of the United States depends largely upon the response given by the public mind to the words of the amendment as proposed by Congress. Therefore it is reasonable to take the words of such an instrument in their ordinary or popular sense and to interpret them in the light of those analogies which come closest to the affairs of daily life in connection with which such words are oftenest used.

It may safely be said that in the experience of the

ordinary man the words "income" and "capital" are oftenest thought of in connection with trust funds and decedents' estates.

October 3rd corresponds to the date when a bequest of income takes effect. All income received or acquired by the testator or the estate before that time is capital.

The method of apportioning stock dividends between life tenant and remainderman, under the so-called Pennsylvania or American rule, furnishes an analogy. Earnings before the life estate arose are capital and go to the remainderman. So much of the dividend as was earned thereafter is considered earnings or income and goes to the life tenant.

So in *Biddle's Appeal*, 99 Pa. St. 278, the Court at page 282 said:

> "The entire value of the stock, with all its incidents, at the death of the testatrix, constituted the principal of the estate. On this principal the appellant was entitled to the income. * * * Whatever was capital must remain capital. The executor could not take therefrom and give to the life tenant, to the injury of the residuary legatee."

And referring to an earlier case:

> "That which had accumulated before the death of the testator, was held to be a part of the principal of the fund, and that which accumulated after his death, to be income."

See also

Goodwin v. *McGaughey*, 108 Minn. 248, at p. 254.

Kalbach v. *Clark*, 133 Iowa, 215, at p. 218.

On the 3rd of October, 1913, it is apparent that the income which had then accrued had taken a multitude of forms and had suffered many changes. It had been used up. It had been lost. It had been placed in banks. It had been invested. It had be-

come a part of this corporation's surplus, of that corporation's plant, of this man's working capital and of that man's real estate.

It is not necessary for us to maintain that in all instances and under all circumstances the income which had accrued during the period concerned had at the time it was taxed not been spent or dissipated but had accumulated and become capital. Beyond dispute, a part, a great part of it, had then become capital. It is enough that it was not income on October 3rd, 1913, and therefore not available as a measure of value of taxable property.

The power to legislate under the Sixteenth Amendment might have remained dormant for ten years. At the expiration of that time, suppose Congress had passed an act taxing all moneys received during the ten years that had elapsed subsequent to the adoption of the Amendment. During that period many fortunes might have been built up entirely out of savings from income, and yet the entire capital of the taxpayer would have been subjected to the tax as income. Further there would be compounding of the tax, for that which was income the first year and taxed as such would be capital producing income the second year, and again taxed through the assessment of its income, and this process would be continued during the ten years. Once admit that Congress has power to legislate with the effect of taxing income received prior to the date of enactment, the conclusion cannot be escaped that there is no limit to the extent of time to be covered by such retroactive legislation. This conclusion follows if the statute be held validly to tax the income from March 1, 1913, to October 3d, 1913.

As the statute which taxes income received prior to October 3rd, 1913, levies a tax upon property, real and personal, directly and without apportionment, it is unconstitutional and invalid.

The decision mainly relied upon to sustain the retroactive feature of the Act of 1913 is *Stockdale* v. *The Insurance Companies*, 20 Wall. 323. That decision, of course, can have no bearing upon the construction of the Sixteenth Amendment, which did not then exist. All that was really decided in that case was that if Congress had power to impose a tax on dividends arising from the earnings of corporations, as an excise tax, (and the power to impose such an excise tax without apportionment based upon any enumeration was a question not raised in the case) then Congress had power to measure the excise tax by earnings already realized, as well as by earnings to accrue in the future. There was no constitutional provision or principle called to the attention of the Court which required the Court to distinguish between a tax on income and an excise tax measured by past income.

The passage in the opinion of the Court upon which the greatest reliance is placed by the Government is the following (p. 331):

> "The right of Congress to have imposed this tax by a new statute, although the measure of it was governed by the income of the past year, cannot be doubted; much less can it be doubted that it could impose such a tax upon the income of the current year, though part of that year had elapsed when the statute was passed. The joint resolution of July 4th, 1864, imposed a tax of five per cent. upon all income of the previous year, although one tax on it had already been paid, and no one doubted the validity of the tax or attempted to resist it."

It is clear that the Court attached more weight to the general acquiescence in "War taxes" on patriotic grounds than would now be considered proper. The excesses of authority on the part of Congress which are acquiesced in in a time of civil war ought not to be made permanently a part of

the constitution of a re-united nation, without some examination in the light of constitutional provisions. It should be remembered, also, that the statute which the Court was construing was not one which imposed a new tax *ab initio*, but was merely one declaring the construction of a prior statute, and it was sustained as valid upon that ground. It is true that the language of the prevailing opinion speaks of imposing a tax upon a year's income, although part of that income had already been spent or had become merged in capital. There was, however, no circumstance in the case which required the Court to consider whether such use of language was strictly accurate or not. It should be borne in mind that there was no suggestion in the *Stockdale* case that the tax in dispute was a direct tax, or that any apportionment among the several states was essential to its validity. That being so, it made no difference whether the tax was technically a tax on income or on something else. The decision is certainly not one which can have any controlling weight in determining the meaning of the word "income" as used in the Sixteenth Amendment.

POINT FIFTH.

The entire assessment of income tax against the defendant for the year 1913 is invalidated by the inclusion therein of the amount improperly assessed relative to the income received between March 1st, 1913, and October 3rd, 1913.

From the considerations presented under the foregoing Fourth Point it necessarily follows that the

Commissioner of Internal Revenue was without jurisdiction to make an assessment of any amount upon the income of the defendants for the year 1913, except upon evidence showing that income had accrued to or been received by the defendant subsequent to October 3rd, 1913. It will not, we think, be disputed by the Government that during the pendency of this suit that the Commissioner did make an assessment upon the income of the defendant for the whole period of ten months, from March 1, 1913, to December 31, 1913, inclusive, without distinguishing in the assessment between the period preceding and that following October 3rd, 1913, and without any evidence as to the receipt of income by the defendant after October 3rd, 1913. This, we submit, makes the entire assessment for the year 1913 void and entitles the plaintiff to an injunction restraining the defendant from paying any part of the tax assessed for said year.

It has repeatedly been held that where an assessment rests in part upon a subject over which the assessing authority has no jurisdiction or where the tax is levied in part for an illegal purpose and no method appears whereby the legal element can be separated from that which is illegal, the whole tax, or the whole assessment, as the case may be, is void.

Stetson vs. *Kempton*, 13 Mass. 272, was the case of a tax levied in part for an illegal purpose, It was held that the act of the collector in seizing the property of the plaintiff's intestate for the payment of the tax was a trespass and could not be partially justified by showing that some of the purposes for which the tax was levied were legal. The Court said:

> "It is further objected, that, as part of the money composing this tax was raised for legal purposes, the assessment must be considered so far legal as to support the warrant issued by the defendants; otherwise, they may be held to pay

in damages for money which lawfully belonged to the Town. But when a part of the tax is illegal, all the proceedings to collect it must be void; as it is impossible to separate and distinguished, so that the act should be in part a trespass and in part innocent."

Libby vs. *Burnham*, 15 Mass. 144, was likewise the case of a tax raised in part for illegal purposes. The action was trespass against officers who made a seizure of plaintiff's oxen for the collection of the tax. The Court said (p. 148):

"A tax is no debt, until it is assessed and demanded; and if not legally assessed, it is the same as if never assessed at all; so that to reduce the damages, on the ground that the plaintiff owed a part of the money claimed from him, would be unauthorized by legal principles.

What then, is to be done, when assessors have neglected their duty or gone beyond their authority? Is the whole tax to be lost? There is no need of this. The tax may be reassessed, or the town may renew their vote to raise the money. And it is better that they should suffer this inconvenience than that the property of the citizen should be taken from him, to satisfy arbitrary exactions, limited by no rule but the will of assessors. Strictness in these particulars is wholesome discipline—as it will, from motives of interest, produce care and caution in the selection of town officers, and diligence in them when chosen."

To the same effect is the decision in *Joyner* v. *Third School District*, 3 Cush. 567 and *Freeland* v. *Hastings*, 10 Allen, 570.

Johnson v. *Colburn*, 36 Vt. 693, was likewise the case of a tax levied in part for illegal purposes. The plaintiff sued in replevin for a cow taken under a warrant for the collection of the tax. The Court said (p. 695):

"If any part of the tax is void, it being entire, the whole is void."

In *Lacey* v. *Davis*, 4 Mich. 140, it was held that where the supervisor in levying a tax without any action of the electors or the township board added a certain amount to the tax roll for township expenses, the whole tax was void and a title acquired by sale thereunder was ineffective.

In *Clarke* v. *Strickland*, 2 Curt. 439 (Fed. Cas. 2864), it appeared that county commissioners in levying a tax had assessed a larger sum than was granted by the Legislature. The District Judge, following *Stetson* v. *Kempton*, *supra*, and *Libby* v. *Burnham*, *supra*, said:

> "The additional tax imposed by them was an an excess of power that rendered the whole tax void so that the State tax was all that was legally due."

A like conclusion was reached in the case of an excessive tax in *Worthen* vs. *Badgett*, 32 Ark. 496.

In *Union National Bank* v. *Chicago*, 3 Biss. 82, Judge BLODGETT granted injunctions against the collection of taxes based upon an assessment of the property of the plaintiff, including certain shares of national banks. Having reached the conclusion that such taxation was void as to all shareholders not residing in the district where the bank was located, he held that it must be void in its entirety.

In *Santa Clara County* v. *Southern Pacific R. R.*, 118 U. S. 394, this Court adopted and followed the rule laid down in *Libby* v. *Burnham*, *supra*, and *Johnson* v. *Colburn*, *supra*, in respect to the validity of the tax embracing some illegal elements. In that case it appeared that the assessment considered by the Court was made by the State Board of Equalization, which was required by law to assess the franchise and roadway of railroad companies. In making this assessment they had included the value of fences which the railroad company was required by law to maintain between its own land and that of

adjoining proprietors. The Court reached the conclusion that these fences were not a part of the roadway and that the assessment thereof was not within the jurisdiction of the State Board of Equalization. Consequently, the Court held that the entire assessment was void. Mr. Justice HARLAN, delivering the opinion of this Court, said (p. 416):

> "The case as presented to the court below was therefore one in which the plaintiff sought judgment for the entire tax arising upon an assessment of different kinds of property as a unit—such assessment including property not legally assessable by the State Board and the part of the tax assessed against the latter property not being separable from the other part. Upon such an issue the law, we think, is for the defendant; an assessment of that kind is invalid and will not support an action for the recovery of the entire tax so levied."

In *Alexandria Canal Co.* vs. *District of Columbia*, 5 Mackey, 376, the Supreme Court of the District, following the decision of this Court in *Santa Clara County* vs. *Southern Pacific R. R.*, *supra*, held that where a tax was levied in part upon the real and personal property of the plaintiff and in part upon its franchise the inclusion of the latter element was without jurisdiction and the whole tax was void.

In *Alexandria Canal Co.*, 1 Mackey, 217, it appeared that the assessor had included in his assessment the value of an entire bridge, part of which was within the jurisdiction of the State of Virginia. The Court held the entire assessment to be void.

Conclusion.

The plaintiff is entitled, therefore, to an injunction against the payment of any part of the tax assessed upon the defendant for the year 1913.

POINT SIXTH.

The decree dismissing the bill of complaint herein should be reversed and the appellant should be adjudged to be entitled to a decree enjoining the defendant, the Union Pacific Railroad Company:

First: From including in its returns of income and paying a tax upon amounts received by the defendant as dividends upon stock held by it in other corporations.

Second: From making any returns and any payments relating to the normal tax upon those entitled to the payment of coupons and registered interest upon its bonds, and, generally, from compliance with the provisions of the Income Tax Law with respect to collection of income tax at the source.

Third: From paying any tax upon its income for the year 1913.

September 18, 1915.

JULIEN T. DAVIES,
BRAINARD TOLLES,
GARRARD GLENN,
Morton O. Ellsworth

Of Counsel for Appellant.

IN THE

Supreme Court of the United States.

OCTOBER TERM, 1915.

No. 140

FRANK R. BRUSHABER,

Appellant,

vs.

UNION PACIFIC RAILROAD COMPANY.

No. 693.

TREE REALTY COMPANY,

Plaintiff-in-Error,

vs.

CHARLES W. ANDERSON, Collector of Internal Revenue.

No. 694.

EDWIN THORNE,

Plaintiff-in-Error,

vs.

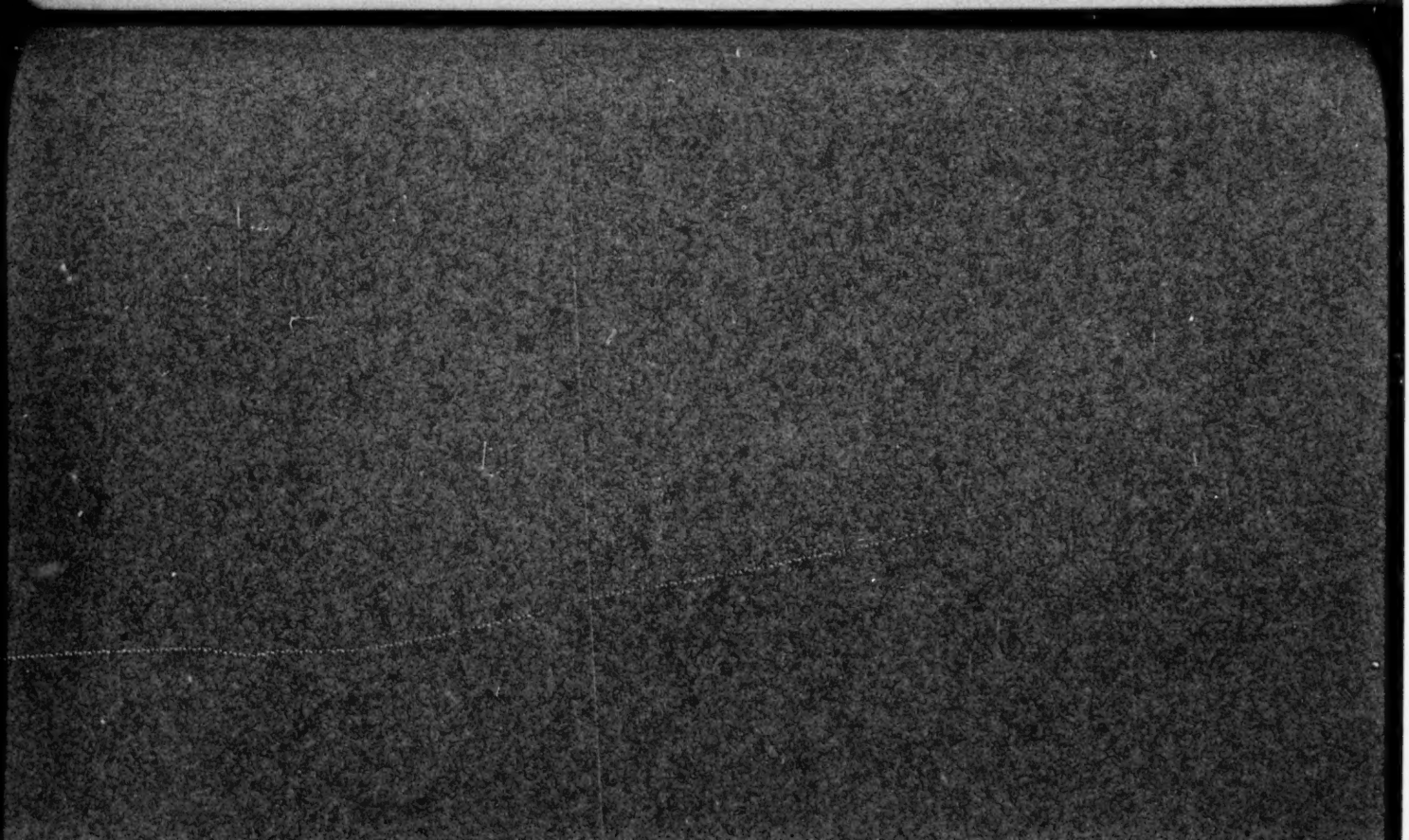
CHARLES W. ANDERSON, Collector of Internal Revenue.

ARGUMENT

OF

JULIEN T. DAVIES.

Law Union Print & Publishing House, Inc., 120 Pearl St., N. Y.



OPENING ARGUMENT.

Mr. Davies: May it please the Court, in these cases that are argued together, there are different questions presented, and while there are some questions that are common perhaps to all of the cases, I shall present those that are peculiar to the three cases that have been first named by your Honor, the Brushaber case, the Tyee case and the Thorne case.

The Brushaber case is a suit brought by a stockholder of the Union Pacific Railroad Company against that company to restrain it from voluntarily paying certain taxes assessed or claimed under the income tax law, section 2 of the Tariff Act of 1915. The other cases, the Tyee Realty Company case and the Edwin Thorne case, are suits brought against the Collector of Internal Revenue to recover back income taxes after they had been paid under protest and duress, and after an appeal had been denied by the Commissioner of Internel Revenue.

All of these cases were disposed of below on demurrer, and judgment was granted against the complainant in the first case, and the plaintiffs in the two other cases, and they come here appropriately by writ of error in the two law cases and by appeal in the equity case.

The questions in the Brushaber case that are presented are these:

First, that the Union Pacific Railroad Company should be restrained and enjoined from voluntarily paying under the provisions of the Tariff Act, the normal tax of one per cent. upon the dividends received by it upon stock that it held by way of ownership in other corporations.

The second question is that the Union Pacific Company should be restrained from acting as collector at the source voluntarily paying to the Government not its own taxes, but taxes assessed against or claimed against bondholders and recipients of interest, either by way of coupons or registered interest.

The third question in the Brushaber case is that the company should be restrained from voluntarily paying a tax upon its own income for a period from the first of March, 1913, the day when the Constitutional Amendment, the 16th Amendment, was adopted, until October 3, 1913, the date when the Tariff Act was enacted and Congress used the power which had been conferred upon it by the 16th Amendment.

In the Tyee Realty Company case there are two questions that are presented to the Court.

One is the question of discrimination against the corporation, growing out of its indebtedness.

The Tyee Realty Company is a corporation that has a capital stock of $10,000, and a mortgage debt of $270,000. The rule enacted by the income tax law was that a corporation, in ascertaining its net income, should not be allowed to deduct all the interest paid upon its bonded indebtedness, but might deduct only the interest upon an amount of bonded indebtedness which was equal to the sum of one-half of its indebtedness, plus the par of its capital stock.

Your Honors will see, of course, that in the case of a corporation like this, whose capital stock is less than its bonded indebtedness, the corporation does not deduct, in estimating its income, all of the interest that it pays. Here we have $270,000 of mortgage bonds and $10,000 of capital stock. One-half of the mortgage indebtedness would be $135,000, to which can only be added the capital stock, $10,000. We, therefore, can deduct the interest only upon $145,000

in place of the right to deduct the interest on $270,000; whereas a corporation similarly situated that has a bonded indebtedness of $270,000 and a capital stock of $135,000, can deduct interest on indebtedness equal to one-half of the indebtedness, $135,000, plus the amount of the capital stock, $135,000, making $270,000, the whole amount of the mortgage indebtedness.

That concrete example shows to the Court the discrimination against corporations which happen to have a capital stock less than one-half of their indebtedness.

In the Tyee case, also, the question is presented of paying the tax upon income received before the act was passed by Congress.

In the case of Edwin Thorne we present only the questions of the validity of the sur-tax, upon incomes over $20,000, and the validity of the tax on income received before October 3, 1913.

While the bill of complaint in the Brushaber case sets forth a great many other imperfections and objections to the act, these are the only ones that we here argue, and I would call the attention of the Court to the fact that every one of these questions does not involve the sweeping and tremendous consequence that would arise from declaring the Income Tax Law as a whole invalid. No such attack upon the law is made here—at least by me—and I simply present to the Court these particular questions, the decision of every one of which, in accordance with our views, would not disturb the tax law as a whole, though it would probably seriously interfere with its operation, and would pare off from it, as we think, excrescences and invalid provisions.

My time is so short that I am not going through the allegations of the complaint. They are all set forth in the brief. The Court will assume, I hope, that in the absence of any objection, and no objec-

tion is made by the Government, that my allegations in the bill in the Brushaber case and in the other cases are sufficient to raise the questions which I bring before the Court. But the Government does raise a jurisdictional question with respect to the Brushaber case, but not with regard to the two actions at law.

The contention is—and this is the only objection that is made to the suit—that it seeks to do indirectly what the Revised Statutes have said shall not be done; namely, enjoin the collection of a tax. The answer to that objection by the Government is that the bill does not seek to do any such thing. It does not seek to enjoin the collection of a tax. It does seek to enjoin the voluntary payment of a tax; in other words, the bill demands that the Union Pacific Road in its dealings with the income tax, should protect the interests of the company and of the stockholders by not voluntarily paying certain taxes, with the effect, that if the taxes be paid, the company should pay them under such circumstances, that if it eventually turns out that the taxes are invalid, the company is in position to recover them.

Therefore, the argument that the bill violates that provision of the Revised Statutes, even supposing that it applies to such a suit as this, where the action is properly brought by the stockholder against the corporation, cannot be upheld.

As a second proposition, with respect to the scope of the bill, we would call attention to the fact that by reason of the fact that the expense to the defendant of acting as assessor and collecting bondholders' taxes for the Government is between five and ten thousand dollars annually, we are asking that the Union Pacific be restrained from voluntarily paying the taxes of third persons, and, in no event, I take it, would this provision of the Revised Statutes apply to an action brought by a stockholder against his corporation to restrain that

corporation from paying not its own tax, but the tax of a third person, and in our attack upon what is called collection at the source, contained in the income tax law, we are only asking that the taxes of third persons be not paid by the Union Pacific.

The Sixteenth Amendment.

The first matter that I want to bring to the attention of the Court is a general view of the 16th Amendment. The language of the 16th Amendment to the Constitution is as follows:

"Congress shall have power to lay and collect taxes on incomes from whatever source derived without apportionment among the several states, and without regard to any census or enumeration."

The first thought is that it is a grant of power to Congress to lay taxes upon incomes from whatever source derived, as a class; that a specific piece of property, a specific kind and class of property, to wit, incomes, is taken out and is relieved from the restraint of the Constitution, that direct taxes upon property can only be laid by apportionment with respect to numbers.

The class of property that is subject to the tax is incomes, generally, and therefore, it was a general income tax, an income tax upon the income of all the property of the tax payer, from all sources, that was permitted to be levied, without apportionment.

Of course, I need dwell but for a moment upon the history of the amendment. We all know, because this Court has so decided, that the general Income Tax of 1894 was invalid, for the reason that a general income tax upon all the income from a man's real and personal property was a direct tax upon that property. After the Court had held that that tax was a direct tax and therefore, under the provi-

sions of the Constitution, could not be levied without apportionment among the several states, according to population, this amendment was passed to meet the difficulty raised in that case, and the language of the amendment indicates that it was one class of taxes that were allowed to be laid upon one class of property, and that the only case in which direct taxes were permitted to be levied by Congress without apportionment according to population was that of a general income tax upon all the income, taken as whole, upon the bulk of a man's property, real and personal.

And further, when the word "income" was used, it was meant income that was net. It was not gross income, that could be taxed in the case of some corporations or individuals, but it was in every case the income from whatever source derived, the income as a whole of the taxpayer, and that necessarily must be net income, because the ordinary meaning of the word "income" is not gross income or gross receipts, but net income, after making the deductions which diminish a man's income and diminish the ultimate profit to him as a result of his entire activities. Suppose the income tax—as an illustration of what I am trying to express—suppose the income tax law had provided this: That the incomes from all the gold mines in the United States should pay at a certain rate, and the incomes from all of the silver mines in the United States should pay at another rate. There we would have a classification of incomes and also a classification of the properties producing the incomes. We would not have in either of those taxes, I venture to say, a tax which Congress was authorized to lay by the 16th Amendment, because we would not have a tax that was in reality a tax on income. The essence of a tax, and the essence of the incidence of taxation, is that it falls upon that which is the differentiating characteristic of the subject of the tax. An income tax, gen-

erally speaking, is a tax upon the income as a whole of the taxpayer; a tax upon the income of the taxpayer derived from gold mines is no longer an income tax. It is a tax upon gold mines. The specification as the subject of the tax of income of a gold mine furnishes a differentiating characteristic from other taxes on incomes.

That illustrates the thought that I am trying to bring before the Court, that a proper construction of the 16th Amendment is this: That it involves the general features of a general tax upon the income of the taxpayer, taken as a whole, and therefore, that varying rates under the income tax, selection of certain subjects and certain kinds of income from specific pieces of property for increased taxation, are not within the power granted, but the moment you get into these specific instances of varying taxes, you have gone beyond the freedom from the restraint of the provision of the Constitution that direct taxes must be laid by apportionment.

If I am right about this, the consequences are that, substantially speaking, no classification with the result of different rates upon incomes can be had under the income tax law. I am not going to argue the proposition which was disposed of in the Pollock case, that certain exemptions—although the question is in the bill—that certain exemptions which have found their way into the act with regard to charitable institutions and life insurance companies should not be allowed —I pass all that.

Bnt we have here in this Act grave discriminations. We have provisions which tax certain corporations at a greater rate than other corporations, who are absolutely their direct competitors and belong in every proper sense and point of view to the same class, and these discriminations exist

not only between different classes of taxpayers, but between members of the same class of taxpayers.

In the Pollock case, on the first argument the Court was equally divided on the question of uniformity, and some very strong opinions were written on that subject. When the case was argued a second time, that question dropped out of the case, because the Court came to the conclusion that the tax on the general income of the taxpayer was a direct tax upon his property, and it was not necessary to decide that question.

If the Court comes to the conclusion that there is this power of classification, which includes the power of imposing different taxes by way of differing rates on different classes of property or upon the same class of property held under differing circumstances, we have the entire protection of the provision of the Constitution that direct taxes should be apportioned according to the populations of the States swept away by this 16th Amendment. There is no half-way house about it.

Congress then would have all the power of the States to impose direct taxation and, therefore, to regulate all the activities of the citizens.

In thus urging that the Sixteenth Amendment shall be confined to its obvious and evident purpose —that of authorizing a general income tax upon all incomes derived from all sources—we are not, as we conceive, advancing an argument that weakens, but rather one that really strengthens, the fiscal powers of Congress. If Congress has power to select out particular sources of income for exclusive taxation —if Congress has power to discriminate and to unequally tax different sources of income—if Congress has power in what purports to be a general income tax law to create discriminations, exemptions and inequalities—the entire field that is now occupied by state taxation and a broader field than that occupied by states whose constitutions contain

a clause requiring equality and uniformity in the levying of taxes would be thrown open for the action of Congress. The halls of Congress will necessarily become a battleground not only for conflict between the interests of different classes of our people of varying degrees of wealth and accumulated property, but between the different classes of owners of different kinds of property, whether individuals or corporations, and of different classes of industrial activity. Struggles will necessarily ensue for the favor of Congress in lightening the load of taxation upon this or that interest, and all the unseemly struggles that have scandalized the country in the enactment of tariff bills will be repeated and extended to the enactment of income tax laws. Such, as it seems to us, would be the consequences of an interpretation of the Sixteenth Amendment that extended the powers of Congress beyond those of enacting a general income tax law upon all incomes from all sources without apportionment.

The questions that I have stated raise the objections of discrimination and classification and of taxation of certain corporations at larger rates than other similarly situated corporations.

Dividends on Stocks.

There is a discrimination with respect to the receipt of dividends derived from stocks that a corporation may hold in other corporations. For instance, the provision of the law is that an individual, in paying his normal tax, can deduct from the amount assessed against him the amount of dividends that he has received upon the stocks of corporations.

The reason of this is that the corporations pay the normal tax of one per cent. on their net incomes.

When you come to a corporation owning stock

in other corporations, you encounter an unreasonable discrimination.

The reason why the corporations should have the deduction is, because the dividends that they receive from stocks that they own in other corporations, have already paid the normal tax, but although that reason exists, the fact does not exist. The corporation is not allowed to deduct from its net income for the purpose of its normal tax the dividends received upon its owned stocks.

It is true that this is not one of these discriminations that are based upon the character of the property. It is based upon the circumstance that a corporation and not an individual owns stocks.

The real grounds of the discrimination are that the corporation, organized by a state, has exercised the power granted to it by the state to hold stocks in other corporations, and that circumstance, which has no relation whatever to the matter of taxation, which does not change the attitude of corporations with respect to their business, has nothing whatever to do with their earning capacity, is a discrimination against companies owning stocks, even if they are not holding companies. This is a discrimination, not against a specific kind of property, but against a specific form of holding property.

It is perfectly obvious that the effect of this discrimination against companies owning stock in other corporations, is to tax them at a greater rate than that imposed upon the corporations which do not hold stock in other corporations, and it is obvious too that it involves taxing at a greater rate the individuals who own stocks in corporations that own stock in another corporation, than individuals that own stock in corporations that own no stock in other corporations. This is discrimination between members of the same class, not merely between different classes.

The effect upon this defendant of this provision of

law is very disastrous. The Railroad Company is the owner of the entire capital stock, amounting to $100,000,000 of the Oregon Short Line Railroad Company, which in its turn is the owner of the entire capital stock (less 15 shares) of $50,000,000 of the Oregon-Washington Railroad & Navigation Company. Both the last named corporation and the Oregon Short Line are consolidations of the original corporations by which branches and extensions of the Union Pacific were constructed. The Union Pacific also owns stock in a fruit express company, an equipment association and various other corporations engaged in business other than railroad business, but incidental thereto. The effect of this discrimination against corporations holding stock in other corporations is to compel the Union Pacific Company to pay three taxes upon income derived through the Oregon-Washington Railroad & Navigation Company and two taxes in the case of income derived through the other controlled corporations, and these thricefold and twofold taxes ultimately fall upon the individuals who own the stock of the Union Pacific Railroad Company, while individuals whose earnings are not derived in any respect from stock of corporations are not subjected to more than one normal tax upon their incomes.

The allowance to individuals, in computing the income for the normal tax, of a deduction of dividends received from corporations is a recognition by Congress of the principle that a corporation is, in substance, an aggregation of its individual stockholders and that whatever affects injuriously the net income of a corporation must finally and ultimately fall upon the individual stockholders. The effect, then, of this denial to corporations of the right to deduct, in ascertaining their net income, dividends of other corporations is to impose a penalty upon individual stockholders of corporations for owning stock in corporations which themselves

own stock in other corporations, and to regulate and discourage the exercise of the right, conferred by the different states who have authorized the organization of these corporations, of a corporation to hold stock in another and of an individual to hold stock in such a corporation. The incidence of the tax in these cases is upon not the income of the corporations but upon the corporation as such and by reason of its holding stock. Is not this a direct tax without apportionment upon the property of such a corporation, not as part of a general income tax upon incomes from whatever source derived, but, in addition to such an income tax, a further burden imposed by reason of the fact of holding stock, and therefore a direct tax upon property without apportionment so far as the excess is concerned? There is no difficulty in dealing with this matter practically without disturbing the operation of the Income Tax Law as a whole. Every corporation knows what part of its net income is derived from the stock of other corporations, and, if entitled to a deduction, the deduction can be allowed either before the tax is assessed and paid or by recovery afterwards without any practical difficulty.

That Congress intended this provision of law as a discouragement to corporations holding stock, whether they were holding companies strictly speaking, or only partially such, and that Congress, considering that it had the power to tax in this manner, intended to exercise its power to destroy, is shown not merely by this provision itself but by other provisions of the Income Tax Law. The Act provides for two cases of presumed fraudulent purpose to escape the tax: one is where the gains and profits are permitted to accumulate beyond the reasonable needs of the business and the Secretary of the Treasury has certified that such accumulation is unreasonable; the other is where the corporation is a mere holding com-

pany. A corporation being a mere holding company is, for that reason alone, presumed to be fraudulent in purpose. This discrimination cannot be upheld without a claim that Congress has the power through taxation of incomes to regulate the mode of ownership of property within the several states by their corporations and their individual citizens. It is well known that the rules in different states are very different in regard to the ownership of stock in corporations by other corporations, and especially railroad corporations such as the defendant. Sometimes the right of such ownership is unrestricted; sometimes the ownership of stock in parallel or competing lines is prohibited.

Reasonable Classification.

Apart from the position that this provision of the Income Tax Law is not within the power granted by the Sixteenth Amendment, this basis of discrimination between corporations is not reasonable and within the adjudicated principles of this Court on that subject. A classification which is unreasonable and founded upon no justifiable element of differentiation is not classification. If there be no true classification and there is a difference in the burden of taxation imposed, there is a case of a discriminating burden being laid upon one member of a class in favor of other members of the same class. That is not, as this Court has held, taxation, but confiscation. Universal is the agreement that arbitrary and unreasonable classification is a violation of the fundamental principles of taxation. Congress has power only to levy taxes. Aids and contributions to government levied in violation of this law of uniformity are not taxes, and cannot be levied by Congress.

It is not necessary from our point of view to argue the proposition that the Fifth Amendment to the Constitution, providing that property

shall not be taken without due process of law and that private property shall not be taken for public use without just compensation, restrains the power of taxation. It is enough for us to adhere to the proposition that a discriminatory burden of taxation placed upon one member of a class that operates for the benefit of the other members of the same class, being not taxation but confiscation, is forbidden by the operation of the Fifth Amendment. It certainly is taking property without due process of law and taking private property for public use without compensation for Congress to confiscate property, even under the guise of the exercise of the power of taxation, when the act complained of is recognized as not being valid exercise of that power.

I do not think it is necessary to call the attention of this court to its repeated utterances to the effect that there is a certain uniformity in connection with matters of taxation that is fundamental, and the want of which takes the action of Congress out of the region of the exercise of the power of taxation. The recent case of *Southern Railway Company* v. *Greene*, and the dissenting opinions of Justices Harlan and Brewer in the *Pollock* case furnish some of the instances of the enunciation of this principle. It is admitted by the Government's brief. The pertinent inquiry always is whether the distinction and classification is a sound and a reasonable one so as to result in the formation of different classes, or whether it is merely a disguise for a selection of an individual or a class to bear an excessive burden. Viewing the corporations of the United States, then, as a whole, without reference to the business in which they are engaged—taking them as a bulk engaged in all the varied activities of corporate life—what reason for distinction is there between one holding stock in another corporation and one which does not? If there be a privilege or advantage in such holding, it is granted by the state of crea-

tion. If this privilege be regarded as a franchise that is the subject of taxation by the operation of the Income Tax Law, then do we have not an income tax but a direct tax without apportionment upon this privilege or franchise granted by the state. But there is no essential difference in the operations of corporations holding stock in other corporations and those who do not.

A corporation as a stockholder of another draws its dividends and exercises its rights as a stockholder, but the exercise of those rights in no way affects the exercise by it of its own corporate franchises and powers or its methods of business in compliance with the laws of the state of its creation. Nor can there be any difference in their relations as stockholders between a corporation as a stockholder of another and an individual as a stockholder of a corporation. Nor is there any difference in the status of an individual who owns stock in a holding corporation and one who holds stock in a non-holding corporation. There is no fact, circumstance or incident that can be suggested as a basis of this classification, except the mere fact that a corporation and not an individual is the stockholder of the other corporation. Now, this fact has no relation to any power that can properly be exercised by Congress. Congress has no right of regulation over the holding of stock in one corporation by another, unless that corporation be engaged in interstate commerce or in the exercise of some power the regulation of which is committed to Congress by the Constitution. Generally speaking, the right to hold stock in another corporation being subject to regulation only by the state of creation of the corporation, a discrimination for purposes of taxation between corporations and between individuals and corporations based solely upon the incident of one corporation holding stock in another necessarily is an interference by Congress with the right of regulation of its corporations by

the state of creation, which is exclusively a matter within the power of that state.

Corporations, in their relation to income, are mere instrumentalities for getting income together and distributing it among those beneficially interested. On no other theory can the discrimination between corporations and individuals in respect to the surtax be justified. This view is recognized in the exemption in the hands of individuals of dividends received from corporations who have necessarily already paid a tax of one per cent. upon their net earnings. Therefore, the discrimination against holding companies is finally a discrimination against stockholders of such companies in favor of stockholders of non-holding companies.

Collection at the Source.

Our claim is that the imposition upon corporations, fiduciaries, employers and debtors of the necessity, at great expense and effort to themselves, of acting as assessors and collectors for the Government, involves the taking of property for public use without compensation.

I would not be understood as taking the position that the Government cannot require corporations and others to assist it in the collection of taxes, but that this burden should be accompanied by proper compensation for the labor and the expense that they are called upon to perform in collecting income taxes at the source.

That duty is not a common law duty. It has no relation to the duties which citizens can be asked to perform for the Government, like military service or jury service or as members of a *posse comitatus.* Corporations and others are called upon to hire clerks, to go to the expense of legal advice, to determine which of the forty-three different forms, issued by the Treasury Department, they must use

in connection with these matters, to look after certificates of ownership and of exemption and, in the case of the Union Pacific Company the bill alleges, and it is admitted by the demurrer, that the annual expense will be at least from $5,000 to $10,000, in performing these services for the Government.

That labor and that expense are taken from the defendant corporation, and taken from its resources for public use, not in performance of any duty which the government has a right to exact, and we present a case of taking private property for public use without compensation.

While the expense of all this to the Union Pacific is at least from $5,000 to $10,000 annually, there are many companies to which it involves the expense of $20,000, $25,000 or $30,000, and I hope that the curiosity of the Court will be sufficiently excited to read a very interesting extract copied into my brief from the remarks of a gentleman who has made a study of the matter.

It is not left to the option of the corporation as to whether it should pay a tax on coupons. It must retain and pay it when the bondholder does not claim an exemption from tax, and there is no requirement of law that he shall claim to the debtor the exemption when he is entitled to it.

I would call attention to the provisions of the law, because the law requires the corporation, in every case, even where the amount of payment is less than $3,000, to deduct the tax when it pays the coupons and registered interest, and pay it over to the Government, unless the bondholder files with the corporation a certificate of claim of exemption. While the bondholder must file a certificate of ownership, he need not claim exemption unless he chooses so to do. The corporation has no means of compelling the bondholder to file that certificate of exemption with it, and one of the consequences of

which we complain is that the Government gets a large amount of taxes from this corporation with respect to bondholders, who really are exempt, but the corporation does not know the bondholders are exempt, and never does know, and the Government gets the money to which it is entitled and the corporation loses it.

While the man who pays it, or for whose account it is paid, has a right to its return, if he is exempt, we can have no relief if he does not choose to tell us he is exempt. In a case like this where the Union Pacific has covenanted that it will pay the Government any tax which it is required to withhold (it is a contract, of course, only between the bondholder and the company, the Government has nothing to do with that), in conformity with its contract with the bondholder, the Union Pacific has to withhold the tax and pay it to the Government, both of which acts are required by the statute. It is no concern of the bondholder to inform us that he is exempt. Even if he be exempt he loses nothing.

The contract between the company and the bondholder only requires it to pay the coupon without deduction of the tax. The onus of paying the Government is put on it by the Act of Congress, not by our contract with the bondholder.

The bondholder does not communicate with the Company at all as to his exemption unless he wishes to. He does not have to.

That is the point, the tariff law places no obligation upon the bondholder, when he is exempt, to claim the exemption from the corporation.

The Union Pacific has to deduct the tax from its coupons, and to pay the tax to the Government.

If you have Union Pacific bonds with a tax-free covenant, you are not bound to do anything about the claim for exemption at all, but you may let the Union Pacific pay the tax, and if you happen to be exempt, the Union Pacific has to whistle for its

money. The bondholder need only file a certificate of ownership with the Union Pacific.

If the bondholder is exempt there is a right to get the money back, but the company has no means of knowing whether or not the bondholder is exempt.

The Union Pacific has to pay the bondholder's tax to the Government in every case where it cannot produce a certificate from the bondholder claiming exemption.

The law requires this.

If it does not, it is liable to a penalty of from $20 to $1,000.

I mean to say that the Union Pacific in this case of an exempt bondholder, who does not claim exemption, pays the tax to the Government and to the bondholder also.

The Union Pacific does not agree to pay the tax, it only agrees to pay the bondholder his full coupon. The Statute requires the company to pay the tax if the bondholder does not claim exemption.

The bondholder may be exempt from tax and not notify the company.

The Union Pacific, by the law, is obliged to pay the tax, and if the bondholder is not courteous enough to file his certificate of exemption, he is not obliged to.

There are in effect two certificates that have to be made in connection with this matter. Every time a coupon is passed in there has to be a certificate of ownership of the coupon, but if the bondholder claims an exemption at the source, then there is a second certificate claiming the exemption. These two certificates are printed upon one form, but the bondholder can draw his pen through the part relating to exemption; also he might be exempt, and yet not claim exemption. The certificate as printed by the Treasury Department does not state a fact as

to exemption, only a claim. The statute does not require a bondholder to claim exemption.

But the point of the matter is this, that while this extraordinary result of the operation of the act is most oppressive and drastic and unjustly takes private property for public use, it really does not bear upon the merits of the proposition at all, that the labor of assisting the collection of taxes for the Government is taking private property for public use without compensation.

In this connection I call attention to the cases on my brief, especially to the case in 178 Alabama, where it was held that the taking of a man's plow horses, wagons and mules for work on the highways, was taking private property for public use without compensation.

Really, the labor of the Union Pacific is comparatively small to what some of the trust companies have been compelled to perform, whose bills of expense run up into many thousands of dollars.

In no previous case connected with collection at the source was any constitutional question raised in opposition to its validity.

Collection at the source cannot be defended as an exercise of the police power of the United States, which can only be exercised to promote the health, comfort, safety or welfare of the community in connection with some matter as to which Congress has a right to legislate.

Unapportioned compulsory service is not a tax. First, it is not definite and generally imposed upon all of a class with substantial equality upon all members of that class; second, collection at the source is a burden of labor and not a pecuniary burden; third, collection at the source does not fall within any of the recognized duties of a citizen such as military, jury or fire duty or service as a member of a posse. Previous cases dealing with collection at the source do not present the ques-

tion that compensation should be made for the labor exacted.

Enforced labor by legislative enactment without compensation is an unconstitutional taking of property (see authorities at p. 52 *et seq.* of brief).

The property of a corporation is taken for public use and without compensation when the inevitable operation of statute in addition to the imposition of large expense in collecting for the Government taxes of third persons, is either to compel the corporation to pay taxes that are not lawfully due or to conduct an expensive and inquisitorial investigation into the private affairs of third persons.

The Act involves unreasonable discrimination and arbitrary classification resulting from the practice of collection at the source:

First, between corporations who are indebted upon bonds and those who are not;

Second, upon corporations who have funded their debts in favor of corporations whose indebtedness is of a floating character, with interest not payable at fixed periods;

Third, between individuals who are debtors, fiduciaries or employers and those who do not occupy those relations.

Fourth, between individuals who have invested in bonds and those who have not.

Such discriminations are unwarranted and not within the grant of power given by the Sixteenth Amendment, and are also unreasonable in their nature. An effect of the discrimination between individuals who have investments in bonds of corporations and those who have not such investments is that the bondholders are deprived of the use and benefit of the moneys withheld to pay their taxes during the period of time between the date of the

withholding and the date of the payment of the tax.

It is admitted that Congress may provide for collection at the source, provided due compensation is made to those who furnish labor and money to the Government in the assessment and collection of the tax. The present provisions of the Income Tax Law make no provision for such compensation and are therefore invalid as violative of the Fifth Amendment.

RETROSPECTIVE TAXATION:

The statute is invalid in the particular of seeking to tax income received prior to October 3rd, 1913.

Your Honors will bear in mind the dates. The Constitutional Amendment was passed on the first of March, 1913. The law was not passed until the 3rd of October, and the law attempts to be retrospective by requiring a tax-payer to make a return of all his income received from the 1st of March, 1913, and to pay the tax thereon.

Our suggestion is that until Congress exercised the power which was conferred upon it by the 16th Amendment, that power lay dormant, and that income received was not affected by the element of taxability without apportionment until the Act was passed on the 3rd of October, and further that income that has ceased to be income is not income for the purposes of taxation.

The statute provides, as the amendment provides, that the tax is to be upon the income, but what had been received prior to the 3rd of October, 1913, while it was income when it was received, ceased to be income the moment it was received. It came into a corporation's treasury or a man's pocketbook, and it was instantly dissolved and became capital the moment it was received. Therefore, on October 3, 1913, while income from that time on was subject

to taxation, income received prior to that time was not then income.

The act, we claim, is invalid so far as it seeks to tax income received between the first of March and the third of October, the date when incomes were made subject to taxation by the action of the Congress.

Income is either money or it is a credit owing from some third person, and immediately passes into some form of property when it is received, or is spent and passes away.

Whatever had been received when Congress taxed incomes on the third day of October, was on the third of October property,—property into which the income had passed, unless it had been expended and vanished. What was previously received becoming property when received, was no longer income; the unexpended portion had remained property; and therefore an attempt to tax the receipts prior to October third was in effect an imposition of a direct tax upon property without apportionment.

There seems to be no escape from the proposition that the tax upon incomes received from March 1st to October 3d, 1913, is a direct tax without apportionment, upon the real and personal property representing that income as a conclusion from previous decisions of this court with respect to the dormant character of powers of Congress that have not been exercised. It is not expected that this court will hold that the Sixteenth Amendment was self-executory and imposed a tax without apportionment from the 1st of March, 1913, upon the incomes generally of real and personal property within the borders of the United States. The Sixteenth Amendment must be read in connection with subdivision 4, Section IX, Article 1 of the Constitution. "No capitation or other direct tax shall be laid unless in proportion to the census or enumeration, &c."

The distinctive characteristic of subjection to taxation was laid upon incomes only when taxation was levied upon them by the Act of October 3d, 1913, and therefore incomes prior to that date were exempt from retrospective taxation by the power of Congress. If this be not so, there would never be any limitation upon the length of time that Congress could go back and tax the incomes received within the United States. Why could not Congress at some future time impose a tax upon the incomes received during the ten years previous to the enactment of the law? Many fortunes of the present day have been entirely built up by savings out of income received during the last, we will say, ten or fifteen years. If Congress could impose a tax upon incomes received during the last ten years, a very large part of what is now the principal of accumulated wealth could be swept into the treasury as income taxes.

Income received prior to October 3d was then free from taxation and free from service as a measure of value of property for the purpose of taxation without apportionment, and the property producing it was free from taxation measured by its income without apportionment and the property or capital into which it had been transformed was equally free from taxation without apportionment. Whatever view be taken of the subject that bears the incidence of the taxation of income received prior to October 3, 1913, that burden could not be imposed by legislation enacted subsequently to its receipt.

Income can only be income once, and that is at the moment of its receipt. Before that moment it is a mere expectation; afterwards it is an increment to capital. It is merged into the general mass of capital, unless it has been spent, and then it ceases to exist as income or anything else. Therefore, a power to tax income can be exercised only by

making it taxable at the moment when it comes in. If the element of subjection to taxation does not adhere to income at the moment of receipt, it never can. Any taxation based upon income previously received is necessarily a taxation either of the property producing the income, or of the property into which the income has passed, and such taxation could not be levied by Congress and made operative retrospectively by the act of October 3, 1913, without apportionment.

The thought that the powers of the Congress may lie dormant until they are exerted was set forth by Chief Justice Marshall in the case of Sturges *vs.* Crowinshield, where the question arose as to whether the State had power to pass an insolvency law provided there was no existing law of Congress on the subject, the Constitution having given the Congress power to pass statutes with reference to bankruptcy; and Chief Justice Marshall said:

"But be this as it may, the power granted to Congress may be exercised or declined as the wisdom of that body shall decide. If in the opinion of Congress uniform laws concerning bankruptcies ought not to be established, it does not follow that partial laws may not exist or that State legislation on the subject must cease. It is not the mere existence of the power but its exercise which is incompatible with the exercise of the same power by the States."

Therefore, it was not the existence of the right to legislate; but it was the act of legislation which for the first time impressed a tax upon incomes. Up to that time the power lay dormant.

I do not advance that as a general proposition retrospective taxation of property is not valid, but I am dealing only with this particular kind of a tax, this income tax without apportionment which was permitted for the first time by the 16th

Amendment to the Constitution. That is the point. Here we have a tax authorized to be laid by Congress on incomes, that was not in fact laid until October 3d, 1913, after that upon which it was laid had ceased to be income.

So far as the income had not been spent on Octo- 3d, 1913, it was property, and the retrospective tax fell upon that property directly without apportionment. So far as the income had been spent, it had ceased to exist on October 3d, 1913. A tax upon spent income is a tax not upon income but upon expenditure. Therefore, a power to tax income can be exercised only by making it subject to taxation at the moment when it comes in, or by laying a tax in anticipation of its coming in that will render it subject to taxation at the moment of receipt.

Let us suppose that the tax was so important in amount that a man would contemplate economy in view of the tax; but he could not have known anything about any tax before the third of October, 1913, after he had spent his income without anticipating any tax.

Suppose the normal tax had been ten per cent.; that would have been a real hardship to many people who followed the course of spending their income as they got it.

I will say only one word on the Stockdale case upon which the Government very much relies. That was a case in which under the old income tax law of 1864 the Court sustained an act which construed a former act, and which had the effect of retrospective legislation on the subject of income taxation; but in that case we did not have this question of direct taxation without apportionment. That question was not raised at that time. It was not discussed; and had that been in the way, I think the decision would have been a very different one, because the moment you go back of the third of October, 1913, you are putting a direct tax upon

property, and that direct tax prior to the passage of the act by Congress could not be levied without apportionment.

No direct tax can now be levied by Congress without apportionment, except upon incomes, unless a very broad construction of the Sixteenth Amendment be adopted, that will permit Congress to levy any direct tax upon any specific property at any rate, in the guise of an income tax upon the income of that property. The concession of the general power of classification as to income taxes involves this result.

This contemplated result accentuates my claim, that the door was only opened by the Sixteenth Amendment, on a crack, so to speak, and that the only thing allowed to be levied without apportionment is a direct tax upon incomes—that is a tax upon incomes as a whole and in bulk.

If there were no provision of any kind in the Constitution for apportionment of direct taxes, and power to lay an income tax was in Congress, and if Congress should pass an income tax and make it retroactive for a reasonable time, two or three months, and fix the date upon which it should be operative, such an act would not be void on the ground that it was not the exercise of a power to levy an income tax. As a tax upon income is a direct tax upon the property that produces the income, or into which the income has gone, and as Congress would in that case have power to impose a retroactive tax upon property, if there were no apportionment restriction, such a retroactive tax upon income would be valid.

But looking at the actual situation before October third, the apportionment provision stands in the way of any such retroactive tax on property without apportionment under the guise of an income tax. If you have not any apportionment provision, nothing stands in the way.

The tax upon income received before and after

October 3d, 1913, is equally a property tax under the Pollock decision. Before October 3d it must be apportioned to be valid, after that date it need not be apportioned.

Even if it be conceded, for the sake of the argument at this point, although we dispute it, that when Congress came to confer upon the Government of the United States by the 16th Amendment to the Constitution the power to levy an income tax, they intended to convey to that Government the fullest conception of the income tax power, divested of and unlimited by the difficulties in the Constitution concerning apportionment, and to except from it as a limitation the income taxing power which is conferred, there would still remain the question whether that which was received by the recipients before October third was income when the act was passed This supposed broad income taxing power is still limited by the necessity of directly taxing not otherwise than with apportionment, the property really taxed through the taxation of income and that which had been income when Congress acted by legislating on October 3d, 1913.

My point largely goes to the meaning of the word income as used in the Amendment, but not entirely. That meaning must be taken in connection with the view of the Pollack case that it is property that is being taxed when income is apparently and in so many words taxed. The question must be met whether income in the Amendment means what has been income or what is income at and subsequently to the time the tax is levied by the Act of October 3d, 1913.

There is no escape from that, absolutely; and I urge that what has been received prior to the passage of the act, when the act is passed is no longer income. It has become capital. The moment it was received it became capital, and stopped being

income. It was received without the element of subjection to taxation. The hand of Congress had not been laid upon it.

I do not recall whether our Congress has ever passed laws imposing import taxes relating back to a period prior to the date of the enactment. It has been done in England.

But there is no question of apportionment there, because such laws provide for excises. Congress may go back and levy customs retrospectively.

Corporate Indebtedness.

In the case of the Tyee Company there is the question of indebtedness, and I have referred to that already. It is evident that a discrimination is made by the provision of the law, that a corporation in ascertaining its indebtedness cannot deduct interest on indebtedness in excess of interest on an amount equal to the sum of one-half of its indebtedness plus the par value of its capital stock, between members of the same class, between corporations having an indebtedness one-half of which is equal to or less than their capital, and those one-half of whose indebtedness is greater than their capital stock. I will spend no more time on that, as it is sufficiently covered in our brief.

Surtax.

The case of Thorne involves the validity of the surtax. The complaint alleges that his normal tax was a certain amount—a very small amount—and the remainder was an additional tax levied upon him because his income exceeded $20,000 per year.

I will only have time to call the attention of the court to certain facts connected with the income tax. They are set forth in my brief at pages, 6, 7 and 8. I assume your Honors are familiar with the provisions relative to the surtax, but let me say

that the computation shows that the results of the discriminations created by the income tax are such that the normal tax upon a man who has an income of $20,000 is less than one per cent., because he has an allowance of $3,000 and, therefore, pays one per cent. on only $17,000.

A man who has an income of $50,000 pays a tax that is equal to about 1-6/10 per cent. of his entire income.

A man who has an income of $75,000 pays a tax of two per cent. of his entire income.

A man who has an income of $100,000 pays a tax of two and one-half per cent. of his entire income.

A man whose income is $250,000 pays a tax of four per cent. of his entire income.

When a man has an income of $500,000 he pays a tax of five per cent

When his income is over $500,000 he pays six per cent. on his entire income.

If a man has an income of $1,000,000 he pays six per cent. on his entire income as a tax.

If his income is over $1,000,000 the percentage of tax increases until it reaches about seven per cent.

Those certainly are discriminations and classifications between members of the same class. It is not discrimination between classes, unless we come to the conclusion that classification by reason of wealth alone, the circumstances of the individuals being otherwise the same, is on a proper basis for the purposes of taxation.

When the Income Tax Act was enacted it was supposed that 500,000 persons would be liable to pay a tax under its provisions. Of this number 456,500 persons were expected to pay a tax on $20,000 and under and 43,500 on over $20,000 in the way of income. In other words, 8.7 per cent. of the taxpayers would pay a super-tax on incomes over $20,000 and 83-1/2 per cent. of the entire revenue to be derived from the Income Tax Law would come from those

liable for the super-tax. This was the estimate publicly announced in Congress as the expectation of the operation of the tax.

As a matter of fact, the realization did not exactly correspond to the expectation and the percentages resulting from the collection of the tax for the ten months of 1913 differed from the statements made in Congress. The returns for 1913 were from 357,500 individuals. Those possessed of incomes over $20,000 paid in surtax 55 per cent. of the entire tax, besides paying their normal tax of 1 per cent. 334,423 individuals paid tax on $20,000 of income and less, while 23,175 persons paid 55 per cent. of the entire tax, besides paying their normal tax of 1 per cent. The results of the collection of the income tax for 1914 were that those possessed of incomes over $20,000 paid in surtax over 67 per cent. of the entire tax, besides paying their normal tax of 1 per cent.

As a general proposition, however, it can be stated that the results of the operation of the Income Tax Law substantially justified the anticipation. Certainly the result shows that for the year 1913 about 7 per cent. of the taxpayers paid in surtax 55 per cent. of the entire tax, besides paying their normal tax of 1 per cent. Generally speaking, therefore, it appears that far the larger part of the income tax is paid by comparatively few individuals through the exaction from them of the surtax.

These inequalities, of course, can only be justified by a defense of the classification on the basis of wealth as involving some principle that makes that classification reasonable and not arbitrary. Indeed, if we examine the writings of the advocates of progressive taxation we find, that the frank admission is made, that progressive taxation is to be adopted, not so much by reason of the necessities of the government for revenue, as, the advisability of bringing

about a distribution of fortunes and discouraging the accumulation of excessive wealth.

The true reason for this classification seems to be the supposed advantage to the State in discouraging the possession of large fortunes. Such a reason seems to be of the same quality as that which lay at the back of the action of the English Parliament in 1691 when Protestants were taxed at a certain rate, Catholics as a class at double the rate of Protestants, and Jews at another and separate rate. But the mere fact that such a reason existed for making this discrimination does not and will not satisfy this court without inquiry into the reasonableness of the reason.

The case of *Knowlton* vs. *Moore*, as I read and understand it, was put upon the proposition that there was a difference between inheritance taxes and property taxes for purposes of taxation and that in connection with questions of taxation, they were distinct. I had not supposed that the decision in that case was put upon the ground that it was within the power of our government to consider the amount taxed in fixing the rate of taxation.

I know that the opinion speaks of the fact that many economical writers consider that the basis of paying taxes according to a man's ability to pay is perhaps a fair way of considering the question of rate of taxation and of classification according to wealth. I had not supposed that the case was decided upon grounds that committed this Court to that proposition. It is that very theory that I venture to suggest to the court is not a fair, reasonable basis for classification.

On the contrary, so far as the weight of evidence goes with respect to economical writers, it is not accepted as a cardinal and sound doctrine of taxation. Much proof of this is contained in our brief. Of course progressive, graduated taxation has been known in various periods of the world's history. It

was known in the Middle Ages, in the Florentine Republic, when after a certain amount, the graduation was carried to a point where the entire income was confiscated. It was known in France in 1794, when an act was passed that all amounts above 9,000 livres should be taxed 100 per cent. and the entire income thus go to the State.

Nor are we without those in this country who are in power and look forward to such a result. During the debate in the Senate upon this Act, a leading Senator expressed the view, that he hoped that some day the time would come when all taxes for the government would be raised by taxing the citizens in proportion to their ability to pay, which simply means taking by way of taxation from the citizen, not his proportion of the expenses of the Goverment in relation to the protection that he and his property receive from the Government, but what is guessed to be his surplus wealth or income after a reasonable provision for his support.

It is a very curious fact in the history of progressive taxation, that in England it found a place in income taxes when the power rested in the hands of the large landholders and the men of wealth during the Napoleonic wars and in the early part of this century. They then had progressive taxation as a part of their income tax system in England. That is to say, the men who had the power recognized that they must take the burden. It was taxation with representation. They were represented to the point of domination in the government, and the extent of their representation was such that they accepted the burden of unequal taxation.

Then, when England grew to be more democratic, when the reform came about in 1832 and the "rotten boroughs" were swept away, graduated and progressive taxation began to lose approbation, and about 1845, I think, it disappeared, and from that time

to 1911 there was no graduated or progressive taxation of income in England. But as the mass of voters gained more power, then we see both in England and in this country, not now progressive taxation on the theory that the men who have the power are the ones who should bear the burden, but on the theory that the men who have the power and have not the wealth should lay the burden upon those who have not the power but have the wealth. In other words, we now have taxation without representation.

What is the effect of this opening wedge, so far as this country is concerned? The law places a tax upon the very wealthy, really for the benefit not only of those who have little, but of those who have a good deal but have not so much. I have called attention to the fact that the man who has an income of $20,000 pays a tax of $170 at the rate of less than one per cent, and that the man who has an income of $1,000,000 pays a tax of $69,000, at the rate of 6.9 per cent; and ordinarily speaking we would think that a man who had an income of $20,000, four per cent on $500,000, was a wealthy man.

So that what we have really got here, without speaking of the effect of the exemption of those comfortably off with an income of $4,000, which is four per cent. upon $100,000, is a law which taxes the very wealthy for the benefit of the wealthy.

The figures will show that with the present law, if there had been no surtax and if the normal rate had been increased from one to two per cent., just as much if not more money would have been raised than was collected by the operation of this surtax. These are facts that may well give rise to the consideration, is this a fair and a just and therefore reasonable classification? While the government contends that this question was decided by *Knowlton* v. *Moore*, I submit that the court in that case

took the view that inheritances had always been the subject of taxation from time immemorial; had always been recognized as clearly within the grasp of the taxing power; that the progressive feature was permitted by the State for the reason that the State had the regulation of inheritances and succession to property by will, and that by some kind of analogy, as long as the United States Government had this power to tax, although the Government had no right to regulate successions and inheritances, it should be held also to possess power to tax by progression. I think it is in the Magoun case that Judge Brewer in his opinion says that if this was a question of the taxation of property he would take an entirely different view of the question of progressive taxation and would hold it unreasonable and confiscatory. If this classification is to be sustained, it necessarily would follow that the whole subject, the whole field of taxation, is thrown open to Congress quite as fully as it is possessed even by the States that have no provision in their constitutions for uniformity and equality of taxation.

It would then be perfectly competent for Congress to enact a provision imposing a tax upon the income from improved real estate of five per cent., a tax of three per cent. upon the income from corporation bonds, and so on—different rates for different incomes upon different species of property. If that is what the 16th Amendment means, then, absolutely, the field of taxation is thrown open completely to Congress, just as completely as to any State, and Congress will have the power, of course, through the enactment of tax laws to control, regulate and even destroy every activity of every kind, corporate and individual, because, as appears from the case of *Veazie Bank* vs. *Fenno*, where Congress taxed State banks out of existence, it is no answer to say that the power to tax could not be exercised as a power

to destroy. It follows, that if the power to tax exists, of course, the power to destroy necessarily exists.

What is the basis of the discrimination by wealth? Simply a certain presumption that an individual who has a large income is better able to pay, is able to pay at a greater rate, than a man who has a smaller income. It is a pure assumption in the case of any individual that he feels a particular tax less than others, no matter what may be the size of his income. Nobody knows what are the calls upon any particular individual; nobody knows what the demands are upon him. He may have a very large income, and yet his relations to his family and to society, and his obligations, may be such that he would feel a tax more than a man with fewer calls and a much smaller income; and no real justice could be brought about except by a minute inquiry in the case of every single taxpayer, thus finding out how the tax fell upon him, and assessing him accordingly. That was done in Florence and in France, but it was found that it was impracticable in operation.

Does the Sixteenth Amendment sanction this method of taxation? Certainly not in terms. The plain and obvious meaning is that incomes are to be taxed uniformly and at the same rate and without discrimination. In the words of Mr. Justice Bradley in the *Legal Tender* cases, let us see how this Amendment is interpreted in the light of history and of the circumstances of the period in which it was framed. I contend that when the Sixteenth Amendment was adopted, what is termed "progression" in taxation was not recognized as part of the system of taxation in this country, either through taxation of incomes or through the form of a graduated tax upon property.

While it is true that some of the income tax laws passed during the time of the Civil War provided for progressive taxation, it is also true that there

never was any discussion of the constitutionality of these laws, while there was some litigation with reference to the mode of assessment and collection and upon the question whether the tax fell upon the individual taxholder or upon the corporation or source that was obliged to pay the tax. In that time of stress and storm the patriotic citizens were more concerned about financial ways and means to subdue opposition to the Union than to criticise the methods employed by taxation or otherwise. It is to be noted, however, that neither the Income Tax Law of 1894, which was declared invalid in the *Pollock* case, nor the corporation excise tax of 1909 made any provision for progressive taxation. So far as I have been able to ascertain, there was no discussion of the theory or idea of progressive taxation in connection with the adoption of the Sixteenth Amendment by the Houses of Congress or by the separate legislatures of the States. The possibility of that feature entering into the law was not presented until after the Sixteenth Amendment was adopted and until the discussions arose in Congress over the Tariff Law, and the happy thought was then brought forward that here was an opportunity under the forms of law to compel the payment unequally and without uniformity of a very large portion of the tax by a few individuals by the operation of unequal rates upon them formulated in connection with the respective amounts of their incomes. All the agitation that was for the Sixteenth Amendment was to overcome the effect of the decision in the *Pollock* case, by which the imposition of a general and universal income tax derived from the employment of real and personal property was prohibited without apportionment.

In view of the decision in the Pollock case that a tax upon the income of real and personal property is a direct tax upon that property itself, if this pro-

gressive income tax be constitutional in the sense that it is taxation and not arbitrary classification, not confiscation, not prohibited as a denial of the equal protection of the laws and due process of law, not the taking of private property for public use without compensation, then there is nothing to prevent Congress from imposing a direct tax upon real or personal property without apportionment, graduated and progressive with respect to the different values of the same kind of property through the guise of a tax upon the incomes of the selected properties.

The unreasonableness of the classification based upon wealth is evident because of the consequent and necessarily discouraging effects upon thrift of the adoption of such a rule. In the best sense it is undemocratic, because it tends to release the many from their fair share of the burdens of government and places the many in the positively immoral position of receiving at the expense of others the benefits of government to which they themselves do not contribute. It is only democratic in the worst sense in that it involves the exercise of the power of the many to take unequally from the few for the benefit of the many.

The only safe and sane rule, and, therefore, reasonable rule of classification is to impose an equal rate of taxation upon property of the same character and subject it to equality of burden.

The history of progressive taxation in this country is that where it is intended to be allowed by constitutional provisions the power is distinctly conferred. The State of Wisconsin and the State of South Carolina authorize by constitutional provision progressive taxation. The absence of such express authorization in the Sixteenth Amendment indicates that the feature of the statute permitting it is not within the power of Congress.

Argument in Reply.

Mr. Davies: May it please the Court, first let me take up the question of jurisdiction that has been raised by the government in the Brushaber case against the Union Pacific Company. The stress of that objection seems to be that the directors of the corporation are to be presumed to have exercised some discretion, in refraining from doing what the stockholders think they should have done, and that it is not for the Court to deal with the question of the propriety of the action of the directors.

I understand that the position of the government in this case is to intervene as *amicus curiæ* to protect the interests of the government in connection with the questions of taxation. I do not understand that the government here represents the Union Pacific Railroad Company or the directors of the Union Pacific Railroad Company in regard to their relations with their stockholder; and when the company itself, and the directors, do not appear here to say that they thought it was bad business judgment not to make returns and not pay the taxes of third persons and the Company's taxes in part, and that they thought it was good business judgment to make the returns for the bondholders, to withhold the taxes for the bondholders, to go to all the necessary labor and expense in connection with the withholding of the tax and paying the tax on the coupons, when the directors themselves do not come here and defend their action, it seems to me it is not for the government or anybody else to suggest that they are qualified to represent the directors and to speak for them.

The Union Pacific Railroad Company has filed a brief in the case, in which it has said only that so far as the questions raised and connected with the validity of the law are concerned, the government hav-

ing been notified of the pendency of the case, all of those questions have been left in the hands of the government. The fact that there is no position on the subject here taken by the company and by the directors seems to leave out of the discussion of this case the question as to what reasons are to be assumed to have governed the directors in going forward and doing what the stockholder asked them not to do and sought to enjoin them from voluntarily doing; and if your Honors will read the letter that is attached to the bill of complaint, that the board of directors of the Union Pacific Company wrote to the complaining stockholder, when the demand was made of the board of directors to take action, your Honors will see that the only reason assigned by the directors was that they did not wish to incur the enormous penalties which the income tax law provided should be imposed upon them if they failed to comply with its provisions. For that reason, and for that reason alone, the directors went forward and did what we asked them not to do.

I would say that the Corbus case is no authority on this question, because it went off on the point that the bill did not show that any demand had been made on the directors to take action before the stockholder filed his bill. The allegations in our bill are complete in that regard, and show that in compliance with the equity rule, the complaining stockholder made a demand of the directors to take action, that there was an emphatic refusal of the directors to act and that there was an utter impossibility of getting the stockholders to act.

I would also further call the attention of the Court to the fact that the practice pursued and the filing of this bill was in accordance with what seems to have been the established practice in this court in connection with similar cases, originating with the case of *Dodge* vs. *Woolsey*. The taxation questions were presented by a similar bill in the Pollock case

and in the *Flint* vs. *Stone Tracy* cases. Eight or ten cases came before this court in connection with the corporation excise law of 1909, and without objection precisely this method was pursued of bringing before the Court the questions of law that were involved in the act that was then assailed. Again, I would say that whatever has been said on that subject is no answer whatever to the right of the stockholder to maintain this bill to restrain the directors from going to the annual expense of $5,000 or $10,000, and thus wasting the assets of the corporation in complying with the invalid requirements of the law in assessing and collecting the taxes of third persons. Nor do I think there has been any answer on the part of the Government to the proposition that the requirements of the law upon corporations, fiduciaries, employers and debtors in calling upon them to assume these onerous duties, and go to these large expenses in acting as assessor and collector for the Government, involve the taking of private property of the corporations and the fiduciaries and other persons, for public use without compensation. All that has been said upon that subject is that such requirements have been contained in former laws, and that they never have been condemned by this court, although never questioned, and that the convenience of the Government is served by conscripting corporations and individuals to serve as collectors at the source.

An examination of the cases in which there has been discussion connected with the collection at the source, in the federal courts, will show that in no case was the proposition ever presented to this court that is presented in this case; in no case did that question arise. There is no ruling upon the proposition that this law in laying the heavy burden of labor and expense upon corporations and individuals in connection with the assessment and collection of taxes of third parties takes private property without

due process of law and for public use without compensation.

I have made no suggestion that the law has not a right to compel the taxpayer to perform a duty in connection with the payment of his own taxes. I have made no suggestion that the government cannot compel corporations, employers, debtors and fiduciaries to perform these duties if compensation is allowed to them, but it is a fact that this burden that is placed upon the business corporations, the trust companies, the banks, the fiduciaries, and trustees and employers of the country, is a load which amounts to hundreds of thousands of dollars annually in expenditures throughout the United States, imposed upon these persons to assess and collect taxes of third persons, without compensation. That is the gist of my complaint. Let compensation be made, and the work can be required.

It is true that under the practical operation of this act individual citizens are required to make returns who are not subject to any tax.

This is true not only of trustees or fiduciaries or employers, but also in some cases, individual citizens, whose incomes are greater than $3,000 or $4,000 if married.

If the individual has more than $3,000 he must make a return.

If a married man whose wife has no income has an income of more than $3,000 and less than $4,000, he has to make a return, and he has to show that he is entitled to a reduction of $4,000, and, that he has not to pay any tax.

But if he is a single man or married man with less than $3,000, he does not have to make a return.

And if he has an income of $6,000 or $10,000, if you like, which is all derived from dividends received upon the stock of corporations, he has to make a return; but he gets a deduction from his income of these dividends, and has not to pay on that income.

So it is true that individual citizens have to make returns in some cases, although they are not subject to a tax under the act.

So it is also true that the class of fiduciaries, debtors, trustees and corporations is not the only class that is burdened with the duty of making returns in the absence of liability to the taxation required by the act itself.

But these facts furnish no argument adverse to the position I am now taking. In the case of the parties referred to, who must make returns although not liable to the tax, they are persons who come within the net in the sense that they would be liable to pay the tax if they had the necessary income, either in amount or kind. They are directly within the purview of the act, and are liable to the taxation imposed by the act, unless certain facts to be shown by them relieve them. They are not dealing with the subject simply in connection with the taxation of third persons, while free themselves from legal liability for the taxes connected with that taxation, except as that liability has been arbitrarily imposed by statute. It is their own taxation, their own property that is subject to the taxation and the necessity exists to make a return to escape taxation. I am speaking on behalf of those who have no relation to the taxation at all of the individuals with whom all this labor is connected, except as the government creates the relation. There is no civic duty on the part of you and me to assess and collect for the government taxes imposed upon third persons.

It is urged that Congress wants to get the income tax, and it would be almost impossible to collect it unless it was gathered in this way.

But the answer is that the convenience of the government in the collection of the income tax does not authorize it to take the property of citizens without compensation, for public use.

As a matter of fact the income tax can be collected without the burdensome provisions for collection at the source. It is merely a question of the government going to the necessary expense itself, or forcing its collectors at the source to bear that expense.

I wish to say just one word upon the question of discrimination. It is admitted in the government brief that there is a line beyond which classification cannot be carried by the government. The government brief speaks of that line as being drawn where the differences are said to be arbitrary and outrageous.

It is said that this court has never decided that it has the power to destroy an act of Congress which is not void under some constitutional limitation. It is said in the case of *Knowlton* vs. *Moore* that it would be time enough to decide whether there was any power to strike down an act of Congress without a constitutional limitation when some question affecting the powers of the government arose in a case in which it was necessarily presented for decision.

I urge that this case presents that question, and that the moment you get an act of Congress which is not within the power of levying taxes, such as the Tariff Act is, in the particulars pointed out, then the 5th Amendment operates. I do not argue for a moment that the 5th Amendment and due process of law restrain the exercise of the power of taxation. The thought upon that head is this, that when Congress acts under the guise of exercising the power of taxation, and goes beyond the line of levying taxes, wherever the court chooses to draw it, then has the citizen the protection of the 5th Amendment, and then is his property taken without due process of law. Valid exercise of the power of taxation is according to due process of law. When we get beyond that line which the court has again

and again referred to, we reach classifications that are not reasonable and which have no basis of true relation to the taxing power. Such classifications, this Court has many times held to be invalid. It has never required the classification objected to, to be outrageous, to be invalid. In the instance that we frequently hear used of the taxation of a man because he is red-headed, for there is no doubt whatever that a capitation tax based upon that circumstance would be said by this court to be invalid, we have a case when the individual has the protection of the 5th Amendment.

May it please the court, we are redheaded. These clients I represent here are in that class. The discrimination is made against us by reason of the fact that we have not capital stock of par value equal to one-half of our indebtedness, the discrimination is made against us that we should pay two or three times the government's tax because the corporation owns stock in another corporation and that corporation owns stock in still another corporation. This additional taxation comes on the individual stockholders, eventually, and there is a discrimination between individuals whose capital is invested in stock in these corporations, and individuals who do not own such stock; and whose capital is otherwise invested.

The Assistant Attorney General made an illustration that admitted the very discriminations of which I am speaking. He spoke of the unjust discrimination that would arise among individuals, from the imposition of a surtax on a corporation when the surtax was also imposed upon the individual. He said that that would be an unjust discrimination against individuals who owned stock in a corporation that had to pay a surtax. That kind of discrimination is the very one I am endeavoring to bring before the court here in connection with these individuals who owned stock in a cor-

poration which has to pay a normal tax upon dividends received upon the stock of another corporation and an individual whose income is entirely derived from a corporation that owns no stock in another corporation. The discriminations I have pointed out in connection with those matters I sincerely submit to the court are unreasonable, they are based upon no substantial difference, not even the difference between the kinds of businesses that the corporations are carrying on; and of course the *Flint* vs. *Tracy* case, which was decided on the proposition that the corporation tax of 1909 taxed simply the doing of business in a corporate capacity has nothing to do with these questions.

An examination of the income tax law of 1894 will show that two of these matters that I have spoken of were allowed in that law: that is to say, that a corporation could take out all the interest upon all its indebtedness in arriving at its net income, and also that a corporation was not taxed on dividends received from other corporations.

The entire assessment of income tax against the three defendants for the year 1913 is invalidated by the inclusion therein of the amounts improperly assessed as income received between March 1st, 1913, and October 3d, 1913.

Where an assessment rests in part upon a subject over which the assessing authority had no jurisdiction, or where the tax is levied in part for an illegal purpose and no method appears whereby the legal element can be separated from that which is illegal, the whole tax or the whole assessment, as the case may be, is void. In the three cases argued together, the Commissioner made an assessment upon the income of the defendant, Union Pacific Railroad Company, and upon the incomes of the Tyee Realty Company and Edwin Thorne for the whole period of ten months from March 1st, 1913, to December 31st, 1913, without distinguishing in the as-

sessment between the period preceding and that following October 3d, 1913, and without any evidence as to the receipt of income by the taxpayers after October 3d, 1913. In each case there is an allegation that a large part of the income assessed was received before October 3d, 1913. This, we submit, makes the entire assessments for the year 1913 void, and the collection of the taxes invalid.

I would respectfully call attention to the briefs filed, and state that I stand upon all the arguments and authorities therein set forth, although I have been able to present *orally* to the Court only a small part of them.

Supreme Court of the United States,

OCTOBER TERM, 1915.

No. 140.

FRANK R. BRUSHABER,
Appellant,

vs.

UNION PACIFIC RAILROAD COMPANY,
Appellee.

APPEAL FROM UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK.

MEMORANDUM FOR APPELLEE.

The appellant, a stockholder of the appellee, instituted this suit, without invitation or encouragement from the appellee, to test the constitutionality of the income tax law (Act of October 3, 1913; 38 Stats., 166). As the only

issue is the validity of the obligations, sought to be imposed by the income tax law on the appellee, to pay taxes on its corporate income and to withhold, report and account for taxes on disbursements made by it supposed to constitute income of others, notice of the institution of the suit was given to the Attorney General with the request that he conduct the defense in view of the primary interest of the Government in the issue. The Attorney General having undertaken to appear and represent in this Court the interests of the Government, it is considered that the appellee is relieved of any obligation to defend the statute and it therefore makes no separate presentation of the case.

Respectfully submitted,

HENRY W. CLARK,

Counsel for Appellee.

October 7, 1915.